



# **Legislative Audit Division**

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**State of Montana**

**Report to the Legislature**

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**November 2005**

## **Financial Audit**

**For the Fiscal Year Ended June 30, 2005**

### **Board of Investments**

**Department of Commerce**

**We performed a financial audit of the Board of Investments for the fiscal year ended June 30, 2005. This report contains the audited financial statements and accompanying notes for fiscal year 2004-05 with comparative totals at and for fiscal year 2003-04. We issued unqualified opinions on the financial statements of the Board of Investments' Retirement Funds Bond Pool, Trust Funds Bond Pool, Short Term Investment Pool, Montana Domestic Equity Pool, Montana International Equity Pool, Montana Private Equity Pool, All Other Funds, and Enterprise Fund.**

**This report contains no recommendations.**

**Direct comments/inquiries to:  
Legislative Audit Division  
Room 160, State Capitol  
PO Box 201705  
Helena MT 59620-1705**

**05-04**

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## FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator  
Office of Budget and Program Planning  
State Capitol  
Helena MT 59620  
Phone (406) 444-3616

Legislative Audit Division  
Room 160, State Capitol  
PO Box 201705  
Helena MT 59620-1705

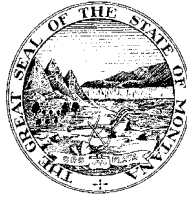
### MEMBERS OF THE LEGISLATIVE AUDIT COMMITTEE

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# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

November 2005

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial audit report on the Board of Investments (board) for the fiscal year ending June 30, 2005. We performed this annual audit of the Board of Investments in compliance with Article VIII, section 13 of the Montana Constitution, and section 17-6-321, MCA. The objectives of our financial audit included determining if the board's financial statements presented fairly its financial position and results of operations at and for the period ending June 30, 2005, with comparative totals at and for the period ending June 30, 2004, and the board's compliance with laws and regulations which have a material and direct impact on the financial statements.

The Board of Investments, originally created in 1971, is attached to the Department of Commerce for administrative purposes. The board employs an executive director and chief investment officer who in turn hire and manage board staff. The staff members advise the board, implement its decisions, and perform daily investment, economic development, and record keeping functions. Included in this report is a list of the members of the Board of Investments and Administrative Officials of the Board of Investments (page i).

This report contains unqualified Independent Auditor's Reports for each of the following eight sets of financial statements of the Board of Investments (page A-1): Retirement Funds Bond Pool, Trust Funds Bond Pool, Short Term Investment Pool, Montana Domestic Equity Pool, Montana International Equity Pool, Montana Private Equity Pool, All Other Funds, and Enterprise Fund. The Independent Auditor's Reports cover two fiscal years because the board presents two fiscal years in the financial statements for comparative purposes. The board's response to this report is on page C-1.

This report does not contain any recommendations to the board. The prior financial-compliance audit report, issued for the two fiscal years ended June 30, 2004, contained two recommendations to the board. We determined the board has implemented one recommendation and the other recommendation is no longer applicable to the board.

We thank the members of the Board of Investments and their staff for their cooperation and assistance during the audit.

Respectfully submitted,

*/s/ Scott A. Seacat*

Scott A. Seacat  
Legislative Auditor

## Appointed and Administrative Officials

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Montana Board of Investments			<u>Term Expires</u>
	Terry Moore, Chairman	Billings	1/2007
	Elouise Cobell	Browning	1/2009
	Teresa Cohea	Helena	1/2009
	Karen Fagg	Billings	1/2007
	Maureen Fleming	Missoula	1/2007
	John Paull	Butte	1/2009
	Jack Prothero	Great Falls	1/2009
	Jim Turcotte	Helena	1/2009
Administrative Officials	Calvin Wilson	Busby	1/2007
	Carroll South	Executive Director	
	Geri Burton	Deputy Director	
	Cliff Sheets	Chief Investment Officer	
	Gayle L. Moon	Accounting Fiscal Manager	

For further information on the Montana Board of Investments contact Carroll South, Executive Director, at:

PO Box 200126  
Helena MT 59620-0126  
(406) 444-0001  
e-mail: [csouth@mt.gov](mailto:csouth@mt.gov)

Members of the audit staff involved in this audit were Pearl M. Allen, Laurie Barrett, Jeane Carstensen-Garrett, Geri Hoffman, Brenda Kedish, Hollie Koehler, and Vickie Rauser.

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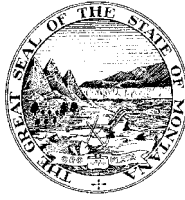
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## **Independent Auditor's Reports & BOI Financial Statements**

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# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Retirement Funds Bond Pool, as of June 30, 2005, and 2004, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Retirement Funds Bond Pool, as of June 30, 2005, and 2004, and its changes in net asset value and investment income and distribution for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

**STATE OF MONTANA BOARD OF INVESTMENTS  
RETIREMENT FUNDS BOND POOL FINANCIAL STATEMENTS**

**STATEMENT OF NET ASSET VALUE JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b><u>Assets</u></b>		
Cash	\$ 0	\$ 0
Security lending cash collateral (Notes 3 and 4 )	214,242,953	215,688,215
Interest receivable	21,273,507	21,278,290
Investments managed at fair value (amortized cost of \$1,752,825,241 in 2005 and \$1,552,369,244 in 2004)(Notes 2 and 4)	<u>1,836,304,371</u>	<u>1,619,985,769</u>
Total assets	\$ <u>2,071,820,831</u>	\$ <u>1,856,952,274</u>
<b><u>Liabilities</u></b>		
Income due participants (Note 2)	10,375,342	11,798,842
Broker payable for securities purchased but not settled (Note 2)	12,000,000	29,517,180
Security lending obligations (Notes 3 and 4)	214,242,953	215,688,215
Security lending expense payable	<u>582,309</u>	<u>190,415</u>
Total liabilities	<u>237,200,604</u>	<u>257,194,652</u>
Net asset value	\$ <u>1,834,620,227</u>	\$ <u>1,599,757,622</u>
Units Outstanding (Note 2)	17,421,903	15,335,617
Unit Value (Note 2)	\$ 105.31	\$ 104.32

**STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Net asset value, beginning of year	\$ 1,599,757,622	\$ 1,611,806,276
Value of units purchased by participants	219,000,000	87,900,000
Value of units sold by participants	0	(2,737,550)
Changes in fair value of investments managed	<u>15,862,605</u>	<u>(97,211,104)</u>
Net asset value, end of year	\$ <u>1,834,620,227</u>	\$ <u>1,599,757,622</u>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Interest income (Note 2 )	\$ 90,313,722	\$ 85,498,351
Amortization/accretion	7,120,260	12,834,615
Net realized gains	21,186,265	15,413,877
Security lending income	4,491,649	1,815,757
Security lending expense	(4,284,986)	(1,628,334)
Administrative expenses	(233,417)	(226,380)
Income due participants, beginning of year	<u>11,798,842</u>	<u>9,800,159</u>
Income available for distribution	130,392,335	123,508,045
Distribution	<u>120,016,993</u>	<u>111,709,203</u>
Income due participants, end of year (Note 2)	\$ <u>10,375,342</u>	\$ <u>11,798,842</u>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS  
RETIREMENT FUNDS BOND POOL**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**1. HISTORY AND ORGANIZATION**

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Retirement Funds Bond Pool (RFBP) was created by the Board to allow qualifying funds, per section 17-6-201, MCA, to participate in a diversified pool. The RFBP was created on April 1, 1995, by the transfer of all fixed income and variable-rate securities owned by the Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Investments**

RFBP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The RFBP portfolio includes securities classified as corporate, foreign government bonds, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

The RFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Some RFBP REMICs are interest-only strips (IOs). Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. IOs receive cash flow from the interest payment component on underlying mortgage loans. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as U.S. government indirect-backed in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 8 for the Year End Portfolio.)

RFBP fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The RFBP variable-rate securities float with LIBOR (London Interbank Offered Rate) or the weighted average of the net mortgage interest rates for the mortgage loan group. The six variable-rate securities, with a total amortized cost of \$52,000,003 and \$250,000, respectively, as of June 30, 2005 and 2004, are identified and reported as corporate or U.S. government indirect-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 8 for the Year End Portfolio.)

The RFBP, as an internal investment pool, invests its excess cash in the Board's Short Term Investment Pool, (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

Investments are presented in the Statement of Net Asset Value at fair value. Fair values are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

**Participant Units**

The Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds transferred all fixed income and variable-rate securities, at amortized cost, into the RFBP at the start-up date and were issued units according to the market value of each participant's portfolio. The initial unit value as of April 1, 1995, was \$100.00. Unit values thereafter are calculated weekly and at month end, based on portfolio pricing, to allow for participant transactions to occur as determined by the investment staff.

The June 30, 2005 unit value of \$105.31 increased from a June 30, 2004 unit value of \$104.32. The yield on longer term bonds decreased during the fiscal year, which has the effect of increasing bond prices and the pool unit value. A one percent



(1%) change in interest rates is expected to have a four to six percent (4%-6%) inverse change in the unit value. RFBP investments are considered long-term in nature.

The Value of Units Purchased by Participants of \$219 million for fiscal year 2005, as compared to \$87.9 million purchased and \$2.7 million sold for fiscal year 2004, reflects the pension funds' portfolio rebalancing. RFBP units were purchased and sold to adjust the pension funds' portfolio towards the stated equity/fixed income asset allocation.

#### Broker Receivable/Payable

RFBP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the RFBP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

#### Other

Accumulated income, recorded as Income Due Participants, is distributed monthly on the first calendar day of each month. Realized portfolio gains/losses are distributed at least annually to the participants.

Interest income reported in the Statement of Investment Income and Distribution includes interest accruals and miscellaneous income.

Administrative expenses incurred by the Board are charged daily to RFBP based on the Board's expenses applicable to RFBP. These expenses include costs for the custodial bank contract.

### **3. SECURITIES LENDING**

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2005 and 2004, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2005 and 2004 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2005 and 2004. Moreover, there were no losses during fiscal years 2005 and 2004 resulting from a default of the borrowers or State Street.

During fiscal years 2005 and 2004, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 35 and 49 days, respectively as of June 30, 2005 and 2004. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2005, the carrying and fair values of the underlying securities on loan for the RFBP were \$199,141,164 and \$208,000,643 respectively. Cash collateral provided for the securities on loan totaled \$214,242,953. The carrying value of the underlying securities on loan is categorized as \$29,436,384 corporate, \$114,129 foreign government bonds, \$102,991,211 U.S. government direct-backed bonds and \$66,599,440 U.S. government indirect-backed bonds.

As of June 30, 2004, the carrying and fair values of the underlying securities on loan for the RFBP were \$198,575,526 and \$209,968,206 respectively. Cash collateral provided for the securities on loan totaled \$215,688,215. The carrying value of the underlying securities on loan is categorized as \$25,908,826 corporate, \$4,368,700 foreign government bonds, \$21,717,255 U.S. government direct-backed bonds and \$146,580,745 U.S. government indirect-backed bonds.

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The financial statement disclosures for the year ended June 30, 2004 have been restated to compare with the financial statement disclosures for the year ended June 30, 2005. The investment risk disclosures are described in the following paragraphs.

##### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the RFBP fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires RFBP fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the table below are provided by S& P's rating services. If an S&P rating is not available, a Moody's rating has been used.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all the fixed income securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The State Street repurchase agreement was purchased in the State of Montana Board of Investments name.

##### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement. According to the RFBP Investment Policy, "with the exception of U.S. government indirect-backed (agency) securities, additional RFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". As of June 30, 2005, the RFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 6.21%. As of June 30, 2004, there were no single issuer investments that exceeded 5% of the RFBP portfolio.

##### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The RFBP investment policy does not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs and ARMs)."

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

As reported in the U.S. government indirect-backed category, the RFBP portfolio holds REMICs totaling \$554,309 and \$1,034,466 in amortized cost, respectively, as of June 30, 2005 and June 30, 2004. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

The Interest Only (IO) securities are more sensitive to prepayments by mortgagees resulting from interest rate changes than other REMIC securities. The IO REMIC securities purchased in August and September 1992 are being reduced periodically towards zero according to the expected average life of the underlying mortgages. The IO securities amortized cost is \$3 as of June 30, 2005 and \$250,000 as of June 30, 2004.

The RFBP holds one inverse variable rate corporate \$25 million par bond. The quarterly coupon is calculated at a increased set rate less the 12 month LIBOR in arrears. As interest rates increase, the coupon paid will decline.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2005 and June 30, 2004. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

#### Credit Quality Rating and Effective Duration as of June 30, 2005

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Corporate Bonds (Rated)	\$ 894,556,479	A-	5.75
Corporate Bonds (Unrated)	19,537,653	NR	4.07
Foreign Government Bonds	5,217,500	BBB	6.67
U.S. Government Direct-Backed	188,790,314	AAA	4.50
U.S. Government Indirect-Backed	605,800,830	AAA	3.91
State Street Repurchase Agreement* (Rated)	9,923,600	AA-	NA
Short Term Investment Pool (STIP)	<u>112,477,995</u>	<u>NR</u>	<u>NA</u>
Total Fixed Income Investments	\$ <u>1,836,304,371</u>	<u>AA-</u>	<u>4.95</u>
Securities Lending Collateral Investment Pool	\$ <u>214,242,953</u>	NR	NA

\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at \$10,169,671 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

#### Credit Quality Rating and Effective Duration as of June 30, 2004

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Corporate Bonds (Rated)	\$ 855,074,117	A-	6.54
Corporate Bonds (Unrated)	19,161,517	NR	2.88
Foreign Government Bonds	4,805,000	BBB-	6.96
U.S. Government Direct-Backed	91,669,717	AAA	8.18
U.S. Government Indirect-Backed	585,521,127	AAA	6.64
Short Term Investment Pool (STIP)	<u>63,754,291</u>	<u>NR</u>	<u>NA</u>
Total Fixed Income Investments	\$ <u>1,619,985,769</u>	<u>AA-</u>	<u>6.63</u>
Securities Lending Collateral Investment Pool	\$ <u>215,638,215</u>	NR	NA

#### Specific Legal and Credit Risk

As of June 30, 2005, Delta Airlines Corp. presented a higher credit risk to the Board. The RFBP holds \$3 million par 10.0% Delta Airlines Corp. bond maturing June 5, 2013, a \$1.971 million par 10.0% Delta Airlines Corp. bond maturing June 5, 2011 and a \$6 million par 10.14% Delta Airlines Corp. bond maturing August 14, 2012. Due to a weak credit outlook and potential bankruptcy, the Board stopped the interest income accruals after the December 2004 and February 2005 pay dates. Although the interest accruals were stopped, the Board received the interest due in June 2005 and August 2005. The combined book value of these securities was \$10,949,050 as of June 30, 2005. Due to the company's filing for Chapter 11 bankruptcy protection on September 14, 2005, the book values were reduced to \$1.5 million, \$985,500 and \$3 million, respectively.

As of June 30, 2005, Northwest Airlines Inc. presented a higher credit risk to the Board. The RFBP held a \$9,930,036 par 6.81% Northwest Airlines Inc. bond maturing February 1, 2020, a \$7,802,614 par 7.935% Northwest Airlines Inc. MBIA Insurance Corp. insured bond maturing April 1, 2019 and a \$5,745,000 par 4.64% Northwest Airlines Inc. real estate backed bond maturing July 7, 2010. The combined book value of these securities was \$22,989,339 as of June 30, 2005. On September 14, 2005, the company filed for Chapter 11 bankruptcy protection. Due to this action, the Board stopped the interest income accruals for the 6.81% bond maturing February 1, 2020 after the August 2005 pay date. This issue was sold on September 20, 2005 generating a loss of \$642,183. The sale included accrued interest from August 1, 2005 to

September 20, 2005. Since the 7.935% bond maturing April 1, 2019 is insured by MBIA Insurance Corp. to support the payment of any interest due and outstanding principal balance, the Board did not stop the interest income accrual or reduce book value. The 4.64% bond maturing July 7, 2010 is secured by Northwest Airlines Inc.'s corporate headquarters building and land.

As of June 30, 2005 and June 30, 2004, Burlington Industries, Inc. presented a legal and higher credit risk to the Board. The Board owns a Burlington Industries, Inc., \$6 million par, 7.25% bond maturing September 15, 2005. In September 2000, the company announced a reduction of stockholders equity. Due to an increasing senior bank line and declining credit trend, the bond ratings for this issue were downgraded, in May 2001, by the Moody's and Standard & Poor's rating agencies. During fiscal year 2001, the book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of \$5,609,640 to \$2,400,000. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to \$1,200,000. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the Board received \$1,454,961 in August 2004 for its unsecured claim. This transaction reduced the book value to \$0 and generated a gain of \$254,961. In February 2005 and May 2005, the Board received an additional \$208,771 and \$194,247, respectively, for its unsecured claim. The Board is expected to receive additional proceeds over the next two to three years.

As of June 30, 2004, Winn Dixie presented a higher credit risk to the Board. The RFBP held a Winn Dixie Trust, \$70 million par, zero coupon bond maturing September 1, 2024. Due to a weak credit outlook and collateral uncertainty, the Board stopped accruing income and reduced the book value to \$5.2 million in February 2004. On February 21, 2005, Winn Dixie declared bankruptcy. On February 28, 2005, the Board sold the bond and recorded a \$4.6 million gain.

#### **5. DEUTSCHE BANK SECURITIES, INC. COMPLAINT**

The Board received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$5 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25, 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$538,632 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The Board tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of \$113.099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the Board received \$5,683,075 in principal and interest plus \$150,000 as a consent fee. As of September 23, 2005, this matter is still pending.

#### **6. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)**

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

The trading system will serve the Board's internally managed portfolios and will be phased in as training is completed. Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Electronic trading for the Short Term Investment Pool will be next followed by the other fixed income portfolios managed by Board Staff.

#### **7. CLASS ACTION LITIGATION**

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 8. YEAR END PORTFOLIO

The June 30, 2005 RFBP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

Security Name	Coupon	Maturity	Par	Book Value	Fair Value	%
SHORT TERM INVESTMENT POOL			112,477,995	112,477,995	112,477,995	6.13%
STATE STREET REPURCHASE AGREEMENT	2.250	07/01/05	9,923,600	9,923,600	9,923,600	0.54%
<b>CASH EQUIVALENTS</b>	<b>2 Issue(s)</b>		<b>122,401,595</b>	<b>122,401,595</b>	<b>122,401,595</b>	<b>6.67%</b>
AA / FT WORTH HQ FINANCE TRUST	5.500	10/05/10	7,925,967	7,925,967	7,712,758	0.42%
AERO 1 HQ FINANCE TRUST	4.640	07/07/10	5,745,000	5,745,000	5,614,071	0.31%
AMERICA WEST AIRLINES EQUIPMENT TRUST	7.930	01/02/19	4,756,695	4,756,695	5,261,618	0.29%
AMERICAN AIRLINE EQUIPMENT TRUST	6.977	05/23/21	8,566,131	8,547,841	7,880,840	0.43%
AMERICAN AIRLINES 1991 EQUIPMENT TRUST	10.180	01/02/13	5,000,000	4,998,464	3,550,000	0.19%
AMERICAN EXPRESS CO	4.750	06/17/09	3,000,000	2,996,030	3,060,939	0.17%
AMERICAN GEN FINANCIAL CORP	4.625	05/15/09	6,000,000	6,022,242	6,030,672	0.33%
ARCHER DANIELS MIDLAND CO	10.250	01/15/06	3,500,000	3,499,410	3,624,671	0.20%
ATCHISON TOPEKA + SANTA FE RY	6.550	01/06/13	6,730,044	6,730,044	7,083,375	0.39%
BANK ONE TEXAS	6.250	02/15/08	4,000,000	3,914,200	4,200,769	0.23%
BANKBOSTON NA	6.375	03/25/08	4,000,000	3,917,974	4,228,864	0.23%
BAYERISCHE LANDESBANK	VAR	09/27/11	25,000,000	25,000,000	25,000,000	1.36%
BELLSOUTH CORP	4.750	11/15/12	2,000,000	1,995,501	2,010,498	0.11%
BELLSOUTH TELECOMM INC	6.300	12/15/15	13,467,800	14,668,428	14,399,583	0.78%
BISHOPSGATE CDO LTD	5.180	06/30/10	30,000,000	30,000,000	30,000,000	1.63%
BORG WARNER AUTOMOTIVE INC	7.000	11/01/06	5,000,000	5,003,632	5,179,683	0.28%
BURLINGTON INDUSTRIES INC	7.250	09/15/05	6,000,000	0	60	0.00%
BURLINGTON NORTHERN RR CO	7.970	01/01/15	3,533,016	3,533,016	4,349,425	0.24%
BURLINGTON NORTHERN RR CO	6.940	01/02/14	3,194,089	3,194,089	3,727,671	0.20%
CANADIAN NATIONAL RAILWAY CO	6.800	07/15/18	6,000,000	5,969,156	7,174,438	0.39%
CANADIAN PACIFIC LTD	9.450	08/01/21	5,000,000	5,132,397	7,321,859	0.40%
CAPITAL ONE BANK	5.000	06/15/09	6,000,000	5,991,032	6,130,602	0.33%
CENTEX CORP	4.550	11/01/10	9,000,000	8,987,505	8,893,431	0.48%
CHAMPION INTERNATIONAL CORP	7.150	12/15/27	7,000,000	6,874,841	8,222,507	0.45%
CHICAGO + NORTH WESTERN RY	8.910	01/01/15	7,798,942	7,798,942	9,349,252	0.51%
CIT GROUP INC	4.750	12/15/10	7,000,000	7,245,860	7,080,906	0.39%
CITICORP CAPITAL II	8.015	02/15/27	4,000,000	3,971,708	4,387,868	0.24%
CITIGROUP INC	6.200	03/15/09	5,000,000	4,870,922	5,343,475	0.29%
CONTINENTAL AIRLINES EQUIPMENT TRUST	6.545	02/02/19	6,590,057	6,590,057	6,375,880	0.35%
CORPORATE PROPERTY REIT	7.875	03/15/16	12,000,000	12,047,590	14,577,978	0.79%
COX COMMUNICATIONS INC	4.625	01/15/10	7,000,000	6,993,496	6,981,520	0.38%
CSX CORP	7.450	05/01/07	3,000,000	3,038,652	3,175,360	0.17%
CSX CORP	7.900	05/01/17	4,588,000	4,586,425	5,848,013	0.32%
DEER PARK REFINING L P	6.470	12/15/08	4,149,700	4,121,474	4,307,496	0.23%
DELTA AIR LINES INC EQUIPMENT TRUST	10.140	08/14/12	2,000,000	2,000,000	850,000	0.05%
DELTA AIR LINES INC EQUIPMENT TRUST	10.140	08/14/12	4,000,000	3,989,204	1,700,000	0.09%
DELTA AIR LINES INC EQUIPMENT TRUST	10.000	06/05/11	1,971,000	1,959,846	827,820	0.05%
DELTA AIR LINES INC EQUIPMENT TRUST	10.000	06/05/13	3,000,000	3,000,000	1,290,000	0.07%
DONNELLEY R R + SONS CO	4.950	05/15/10	5,000,000	4,987,034	5,023,355	0.27%
DOT HEADQUARTERS II LEASE MTG	1.000	12/07/21	30,000,000	25,761,803	26,706,900	1.45%
EASTERN ENERGY LTD	7.250	12/01/16	5,000,000	4,948,666	6,190,832	0.34%
EL PASO NATURAL GAS CO	8.625	01/15/22	5,000,000	5,192,445	5,812,500	0.32%
ENTERGY ARKANSAS INC	4.500	06/01/10	7,000,000	6,969,531	7,001,369	0.38%
FIRST CHICAGO CORP	6.375	01/30/09	4,000,000	3,861,834	4,286,644	0.23%
FIRST UNION BANK NC CHARLOTTE	5.800	12/01/08	6,000,000	5,770,324	6,314,047	0.34%
FLORIDA GAS TRANSMISSION CO	9.190	11/01/24	10,000,000	9,948,503	12,726,526	0.69%
FORD MOTOR CREDIT CO	7.375	10/28/09	8,000,000	8,005,650	7,900,353	0.43%
FORD MOTOR CREDIT CO	7.000	10/01/13	5,000,000	4,884,854	4,797,395	0.26%
FORD MOTOR CREDIT CO	5.700	01/15/10	7,000,000	6,938,234	6,445,144	0.35%
FPL ENERGY NATIONAL WIND LLC	5.608	03/10/24	3,000,000	3,000,000	3,061,200	0.17%
GALENA CDO TRUST	VAR	01/11/13	12,000,000	12,000,000	12,000,000	0.65%
GENERAL AMERICAN TRANSN CORP EQUIP TRST	8.420	01/01/15	7,444,367	7,444,367	8,582,520	0.47%
GENERAL ELECTRIC CAPITAL CORP	8.125	05/15/12	5,000,000	5,196,846	6,073,494	0.33%
GENERAL MOTORS ACCEPTANCE CORP	6.125	08/28/07	5,000,000	5,008,377	4,937,581	0.27%



<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>%</u>
GENERAL MOTORS ACCEPTANCE CORP	6.875	08/28/12	15,000,000	12,958,246	13,704,203	0.75%
GENERAL MOTORS ACCEPTANCE CORP	5.625	05/15/09	9,000,000	9,167,019	8,363,120	0.46%
GTE CORP	7.900	02/01/27	14,000,000	14,000,000	15,223,082	0.83%
GTE SOUTH INC	7.500	03/15/26	9,000,000	8,891,819	9,476,444	0.52%
HOUSEHOLD FINANCE CORP	6.875	03/01/07	4,000,000	3,976,770	4,182,574	0.23%
HOUSEHOLD FINANCE CORP	6.500	11/15/08	5,000,000	4,894,747	5,345,256	0.29%
IBP FINANCE CO CANADA	7.450	06/01/07	3,000,000	2,999,603	3,124,710	0.17%
ILLINOIS BELL TELEPHONE CO	6.625	02/01/25	2,000,000	1,814,963	2,030,414	0.11%
ING SECURITY LIFE INSTITUTIONAL FDG	4.250	01/15/10	7,000,000	6,986,095	6,981,016	0.38%
INTERNATIONAL LEASE FINANCE CORP	4.550	10/15/09	2,000,000	2,006,753	2,018,430	0.11%
INTERNATIONAL PAPER CO	6.875	11/01/23	3,000,000	2,967,285	3,345,128	0.18%
INTERNATIONAL PAPER CO	4.000	04/01/10	4,000,000	4,001,196	3,865,628	0.21%
J P MORGAN CAPITAL TRUST	7.540	01/15/27	6,000,000	5,703,599	6,456,179	0.35%
J P MORGAN CHASE COMMERCIAL MORTGAGE TRUST	4.555	06/12/41	12,000,000	11,999,883	12,094,774	0.66%
J P MORGAN CHASE COMMERCIAL MORTGAGE TRUST	3.053	01/15/38	2,672,372	2,680,027	2,600,771	0.14%
KCT INTERMODAL TRANSPORTATION CORP	6.884	08/01/18	3,472,533	3,472,533	3,851,325	0.21%
KELLWOOD CO	7.625	10/15/17	12,000,000	11,836,774	12,886,860	0.70%
KERR MCGEE CORP	7.125	10/15/27	7,000,000	7,081,879	7,253,750	0.40%
KERR MCGEE CORP	6.950	07/01/24	4,000,000	3,970,435	4,133,092	0.23%
KEY BANK	4.412	03/18/08	5,000,000	5,000,000	5,021,160	0.27%
KEYCORP	4.700	05/21/09	5,000,000	4,999,495	5,079,160	0.28%
KRAFT FOODS INC	4.125	11/12/09	2,000,000	1,991,492	1,983,028	0.11%
LEHMAN BROTHERS HOLDINGS INC	3.950	11/10/09	7,000,000	6,987,832	6,903,001	0.38%
MACMILLAN BLOEDEL LTD	7.700	02/15/26	10,000,000	9,841,409	12,038,152	0.66%
MARSH + MCLENNAN COS INC	7.125	06/15/09	7,000,000	6,996,836	7,572,974	0.41%
MEAD CORP	7.350	03/01/17	11,000,000	10,992,835	12,999,990	0.71%
MED MAP L L C MONTANA	7.060	12/01/15	9,140,000	9,140,000	9,140,000	0.50%
MED MAP L L C MONTANA	7.000	06/01/21	5,940,000	5,940,000	5,940,000	0.32%
METLIFE INC	5.000	11/24/13	5,000,000	4,959,645	5,086,030	0.28%
METROPOLITAN LIFE GLOBAL MTN	4.250	07/30/09	3,000,000	2,998,779	3,010,404	0.16%
MILLENNIUM AMERICAN INC	7.000	11/15/06	4,000,000	3,983,439	4,115,000	0.22%
MOBIL CORP	5.940	01/15/19	8,422,738	8,422,738	9,190,754	0.50%
MORGAN J P + CO INC	0.000	04/15/27	30,000,000	5,821,215	5,784,627	0.32%
NATIONWIDE FINANCIAL SERVICES INC	8.000	03/01/27	6,000,000	5,918,501	6,533,810	0.36%
NORFOLK SOUTHERN CORP	7.700	05/15/17	6,000,000	6,024,639	7,504,399	0.41%
NORTHWEST AIRLINES EQUIPMENT TRUST	6.810	02/01/20	9,930,036	9,579,767	8,577,069	0.47%
NORTHWEST AIRLINES EQUIPMENT TRUST	7.935	04/01/19	7,802,614	7,664,572	8,485,342	0.46%
OCCIDENTAL PETROLEUM CORP	7.200	04/01/28	13,000,000	12,862,250	16,182,251	0.88%
OCCIDENTAL PETROLEUM CORP	8.750	01/15/23	6,000,000	5,957,566	8,391,748	0.46%
OLD REPUBLIC INTERNATIONAL CORP	7.000	06/15/07	4,000,000	3,999,577	4,212,168	0.23%
PACIFIC BELL TEL CO	7.250	11/01/27	6,000,000	5,962,320	6,428,449	0.35%
PANAMERICAN BEVERAGES INC	7.250	07/01/09	6,000,000	5,976,370	6,541,077	0.36%
PHILLIPS PETROLEUM CO	7.125	03/15/28	11,000,000	10,856,249	11,939,122	0.65%
PNC FUNDING CORP	4.200	03/10/08	10,000,000	9,995,785	10,003,020	0.54%
PPL MONTANA LLC	8.903	07/02/20	20,561,686	20,642,287	24,630,834	1.34%
SBC COMMUNICATIONS INC	4.125	09/15/09	3,000,000	2,999,429	2,975,139	0.16%
SECURITY CAP GROUP INC	7.700	06/15/28	3,000,000	3,504,948	4,009,649	0.22%
SONAT INC	7.000	02/01/18	3,000,000	2,999,713	2,775,000	0.15%
SOUTHERN UNION CO	7.600	02/01/24	7,000,000	7,033,937	8,577,976	0.47%
SOUTHWEST GAS CORP	7.500	08/01/06	6,000,000	6,031,007	6,210,515	0.34%
SOUTHWEST GAS CORP	8.375	02/15/11	6,000,000	5,988,026	7,027,760	0.38%
SOUTHWESTERN BELL TEL CO	7.000	11/15/27	3,000,000	2,996,914	3,186,361	0.17%
SUNAMERICA INC	8.125	04/28/23	13,000,000	13,016,674	17,393,243	0.95%
SUPER VALUE INC	7.875	08/01/09	3,000,000	3,002,944	3,344,290	0.18%
TENNECO PACKAGING INC	7.200	12/15/05	5,000,000	5,003,551	5,084,106	0.28%
TEXAS GAS TRANSMISSION CORP	7.250	07/15/27	3,000,000	2,779,483	3,754,188	0.20%
TRANSCONTINENTAL GAS PIPE LINE	7.250	12/01/26	3,000,000	3,002,806	3,240,000	0.18%
TRISTATE GENERATION/TRANSPORT ASSOC	6.040	01/31/18	8,000,000	8,077,942	8,314,160	0.45%

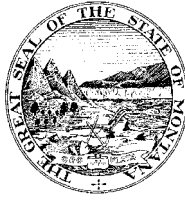
Security Name	Coupon	Maturity	Par	Book Value	Fair Value	%
TYSON FOODS INC	8.250	10/01/11	5,000,000	5,391,409	5,902,618	0.32%
ULTRAMAR DIAMOND SHAMROCK CORP	7.200	10/15/17	3,000,000	2,982,963	3,413,227	0.19%
UNION OIL CO CALIFORNIA	6.700	10/15/07	5,000,000	4,996,302	5,209,743	0.28%
UNION PACIFIC RESOURCES GROUP INC	7.050	05/15/18	12,000,000	11,937,216	13,722,025	0.75%
UNION TANK CAR CO	7.125	02/01/07	6,000,000	5,998,982	6,274,304	0.34%
UNION TANK CAR CO	7.450	06/01/09	5,000,000	5,000,000	5,540,716	0.30%
US BANK NA MINNEAPOLIS	6.500	02/01/08	5,000,000	4,999,625	5,299,412	0.29%
WAL MART STORES INC PASS THRU TRUST	7.490	06/21/07	1,779,418	1,774,006	1,871,365	0.10%
WASHINGTON MUTUAL INC	4.200	01/15/10	9,000,000	8,987,665	8,928,072	0.49%
WESTERN PROPERTIES REIT	7.200	09/15/08	3,000,000	2,943,094	3,243,163	0.18%
WESTVACO CORP	7.650	03/15/27	9,000,000	8,966,526	10,735,240	0.58%
WEYERHAEUSER CO	8.500	01/15/25	7,000,000	7,274,863	9,020,400	0.49%
WILLAMETTE INDUSTRIES INC	7.000	02/01/18	4,000,000	3,979,654	4,423,998	0.24%
XANTERRA SOUTH RIM LLC	5.690	12/15/11	10,000,000	10,000,000	10,000,000	0.54%
ZIONS BANCORPORATION	5.650	05/15/14	4,000,000	3,936,177	4,235,728	0.23%
<b>Corporate Bonds (Rated)</b>	<b>127 Issue(s)</b>		<b>874,682,207</b>	<b>838,067,187</b>	<b>894,556,479</b>	<b>48.72%</b>
FIRST INTERSTATE BANC SYSTEM, MONTANA	7.500	10/01/06	6,230,000	6,230,000	6,230,000	0.34%
AMERICAN PRESIDENT COS LTD	8.000	01/15/24	5,000,000	4,751,614	5,000,000	0.27%
MERIDIAN TRAILER TRAIN EQUIPMENT TRUST	9.850	01/29/10	998,305	998,305	998,305	0.05%
MERIDIAN TRAILER TRAIN EQUIPMENT TRUST	9.850	01/29/08	736,725	736,725	736,725	0.04%
WILMINGTON TRUST TUCSON ELECTRIC	10.211	01/01/09	6,572,623	6,572,623	6,572,623	0.36%
<b>Corporate Bonds (Unrated)</b>	<b>5 Issue(s)</b>		<b>19,537,653</b>	<b>19,289,266</b>	<b>19,537,653</b>	<b>1.06%</b>
UNITED MEXICAN STATES	5.875	01/15/14	5,000,000	4,962,105	5,217,500	0.28%
<b>Foreign Government Bonds</b>	<b>1 Issue(s)</b>		<b>5,000,000</b>	<b>4,962,105</b>	<b>5,217,500</b>	<b>0.28%</b>
ASTRO OFFSHORE CORP USGG XI	6.000	12/20/19	11,691,000	11,691,000	11,691,000	0.64%
ENSCO OFFSHORE CO USGG XI	6.360	12/01/15	7,000,158	7,000,158	7,649,703	0.42%
GLOBAL INDUSTRIES LTD USGG XI	7.710	02/15/25	8,000,000	8,000,000	8,000,000	0.44%
TUNISIA AID USGG XI	6.710	02/01/24	3,900,522	3,721,376	3,900,522	0.21%
USGG SHIPPING + CENAC TOWING USGG XI	7.000	05/15/21	9,655,000	9,655,000	9,655,000	0.53%
VESSEL MANAGEMENT SERVICES INC USGG XI	6.080	05/20/24	11,400,000	11,400,000	12,589,932	0.69%
VESSEL MANAGEMENT SERVICES INC USGG XI	6.750	06/15/25	8,200,000	8,200,000	9,502,734	0.52%
GNMA II POOL 001254	9.500	09/20/19	27,952	27,845	30,966	0.00%
GNMA POOL 046249	10.000	12/15/10	4,682	4,664	5,149	0.00%
GNMA POOL 135544	10.000	01/15/16	68,180	67,910	77,993	0.00%
UNITED STATES TREASURY BONDS	7.250	05/15/16	21,000,000	21,656,877	26,906,250	1.47%
UNITED STATES TREASURY NOTES	3.000	02/15/09	15,000,000	14,596,525	14,649,615	0.80%
UNITED STATES TREASURY NOTES	1.500	03/31/06	25,000,000	24,703,922	24,637,700	1.34%
UNITED STATES TREASURY NOTES	2.750	06/30/06	30,000,000	30,072,095	29,769,150	1.62%
UNITED STATES TREASURY NOTES	3.000	12/31/06	30,000,000	29,897,033	29,724,600	1.62%
<b>U.S. Government Direct-Backed Bonds</b>	<b>16 Issue(s)</b>		<b>180,947,494</b>	<b>180,694,406</b>	<b>188,790,314</b>	<b>10.28%</b>
FEDERAL HOME LOAN POOL B13150	4.000	03/01/19	25,551,689	25,551,689	25,020,019	1.36%
FEDERAL HOME LOAN POOL C01523	5.000	03/01/33	10,935,352	10,846,922	10,971,234	0.60%
FEDERAL HOME LOAN POOL E00247	5.500	10/01/08	882,843	881,304	906,811	0.05%
FEDERAL HOME LOAN POOL E00659	6.000	04/01/14	661,853	661,440	685,406	0.04%
FEDERAL HOME LOAN POOL E01376	4.000	04/01/18	23,788,130	23,622,397	23,312,367	1.27%
FEDERAL HOME LOAN POOL E01418	4.000	07/01/18	23,901,787	23,352,410	23,404,448	1.27%
FEDERAL HOME LOAN POOL E01425	4.500	08/01/18	24,092,467	24,032,830	24,002,967	1.31%
FEDERAL HOME LOAN POOL E99081	4.500	09/01/18	22,209,825	22,083,113	22,127,319	1.20%
FEDERAL HOME LOAN POOL G10173	6.000	01/01/09	717,401	716,560	742,482	0.04%
FEDERAL HOME LOAN POOL G11670	4.000	03/01/15	33,306,281	32,770,727	32,615,075	1.78%
FEDERAL HOME LOAN POOL G30006	7.000	07/01/13	475,526	478,024	496,247	0.03%
FEDERAL HOME LOAN BANKS	6.395	06/03/14	4,000,000	3,771,139	4,593,770	0.25%
FEDERAL HOME LOAN BANKS	7.000	08/26/19	8,000,000	7,976,543	10,185,336	0.55%
FEDERAL HOME LOAN BANKS	7.450	02/03/20	15,000,000	15,089,515	19,925,475	1.09%
FEDERAL HOME LOAN BANKS	3.750	02/07/28	5,000,000	4,996,093	4,973,915	0.27%
FEDERAL HOME LOAN BANKS	4.125	08/13/10	25,000,000	25,265,891	25,052,425	1.36%
FEDERAL HOME LOAN BANKS	5.000	08/28/19	15,000,000	15,000,000	15,000,000	0.82%

<b>Security Name</b>	<b>Coupon</b>	<b>Maturity</b>	<b>Par</b>	<b>Book Value</b>	<b>Fair Value</b>	<b>%</b>
FEDERAL HOME LOAN BANKS	VAR	05/26/10	15,000,000	15,000,000	14,993,640	0.82%
FEDERAL HOME LOAN MORTGAGE CORP	5.125	11/07/13	13,000,000	12,925,082	13,049,504	0.71%
FEDERAL HOME LOAN MORTGAGE CORP	5.000	06/18/18	15,000,000	15,000,000	14,798,040	0.81%
FEDERAL HOME LOAN MORTGAGE CORP	4.000	06/12/13	13,000,000	11,999,674	12,639,900	0.69%
FEDERAL HOME LOAN MORTGAGE CORP	4.000	07/18/18	15,000,000	15,000,000	14,694,932	0.80%
FEDERAL HOME LOAN MORTGAGE CORP	4.500	04/02/14	11,000,000	10,961,482	10,895,940	0.59%
FEDERAL HOME LOAN MORTGAGE CORP	4.100	01/28/14	35,000,000	35,000,000	34,911,065	1.90%
FEDERAL HOME LOAN MORTGAGE CORP	5.000	01/30/14	13,000,000	12,996,315	13,034,931	0.71%
FEDERAL HOME LOAN MORTGAGE CORP	0.000	06/21/32	100,000,000	15,631,516	16,220,000	0.88%
FEDERAL HOME LOAN MORTGAGE CORP	8.250	06/01/26	8,000,000	8,300,734	11,399,280	0.62%
FEDERAL HOME LOAN MORTGAGE CORP	0.000	06/05/28	150,000,000	31,602,050	33,199,650	1.81%
FEDERAL HOME LOAN MORTGAGE CORP	0.000	09/14/29	100,000,000	19,270,393	20,532,500	1.12%
FEDERAL HOME LOAN MORTGAGE CORP	3.500	09/15/07	10,000,000	10,092,889	9,938,590	0.54%
FEDERAL HOME LOAN MORTGAGE PC REMIC	9.300	11/15/20	123,348	120,376	122,935	0.01%
FEDERAL HOME LN MTG PC REMIC IO	VAR	08/15/07	739,043	1	5,462	0.00%
FEDERAL HOME LN MTG PC REMIC IO	VAR	09/15/07	516,380	1	3,814	0.00%
FEDERAL NATIONAL MTG ASSN REMIC	9.500	03/25/20	439,053	433,930	480,416	0.03%
FEDERAL NATIONAL MTG ASSN REMIC IO	VAR	08/25/07	735,175	1	35,423	0.00%
FEDERAL NATIONAL MORTGAGE ASSN	6.000	05/15/08	30,000,000	29,625,051	31,706,103	1.73%
FEDERAL NATIONAL MORTGAGE ASSN	7.250	01/15/10	17,000,000	16,997,319	19,270,840	1.05%
FEDERAL NATIONAL MORTGAGE ASSN	6.625	11/15/10	5,000,000	5,116,827	5,612,292	0.31%
FEDERAL NATIONAL MORTGAGE ASSN	2.800	03/01/19	10,000,000	9,923,478	9,936,390	0.54%
FNMA POOL 109031	6.695	08/01/05	122,492	122,461	122,478	0.01%
FNMA POOL 303125	7.500	01/01/10	438,256	437,386	454,478	0.02%
FNMA POOL 303202	6.500	05/01/14	822,491	816,563	852,155	0.05%
FNMA POOL 303365	6.500	05/01/09	1,289,313	1,279,121	1,344,360	0.07%
FNMA POOL 303590	7.000	11/01/10	497,776	497,776	522,101	0.03%
FNMA POOL 313999	6.000	02/01/13	914,575	911,107	947,263	0.05%
FNMA POOL 572220	6.000	03/01/16	1,031,888	1,029,472	1,068,125	0.06%
FNMA POOL 592327	5.500	06/01/16	2,083,466	2,043,513	2,143,773	0.12%
FNMA POOL 725346	4.000	03/01/19	26,250,466	25,987,870	25,750,076	1.40%
FNMA POOL 780956	4.500	05/01/19	26,653,431	26,645,585	26,552,967	1.45%
U S ARMY HOSPITALITY FUND	7.467	05/01/32	14,546,111	14,546,111	14,546,111	0.79%
<b>U.S. Government Indirect-Backed Bonds</b>		<b>49 Issue(s)</b>	<b>875,726,417</b>	<b>587,410,682</b>	<b>605,800,830</b>	<b>32.99%</b>
<b>RFBP Total</b>		<b>200 Issue(s)</b>	<b>2,078,295,365</b>	<b>1,752,825,241</b>	<b>1,836,304,371</b>	<b>100.00%</b>



# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Trust Funds Bond Pool, as of June 30, 2005, and 2004, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Trust Funds Bond Pool, as of June 30, 2005, and 2004, and its changes in net asset value and investment income and distribution for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

STATE OF MONTANA BOARD OF INVESTMENTS  
TRUST FUNDS BOND POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2005 AND 2004

	<u>2005</u>	<u>2004</u>
<b><u>Assets</u></b>		
Cash	\$ 0	\$ 1,068,110
Security lending cash collateral (Notes 3 and 4)	159,415,025	174,252,479
Interest receivable	16,775,208	17,996,911
Investments managed at fair value (amortized cost of \$1,270,289,093 in 2005 and \$1,228,326,752 in 2004) (Notes 2 and 4)	<u>1,331,695,138</u>	<u>1,272,454,411</u>
<b>Total assets</b>	<b>\$ <u>1,507,885,371</u></b>	<b>\$ <u>1,465,771,911</u></b>
<b><u>Liabilities</u></b>		
Income due participants (Note 2)	\$ 8,228,520	\$ 8,651,899
Broker payable for securities purchased but not settled (Note 2)	9,000,000	20,008,860
Security lending obligations (Notes 3 and 4)	159,415,025	174,252,479
Security lending expense payable	<u>401,325</u>	<u>167,835</u>
<b>Total liabilities</b>	<b><u>177,044,870</u></b>	<b><u>203,081,073</u></b>
<b>Net asset value</b>	<b>\$ <u>1,330,840,501</u></b>	<b>\$ <u>1,262,690,838</u></b>
Units Outstanding (Note 2)	13,130,701	12,623,470
Unit Value (Note 2)	\$ 101.35	\$ 100.03

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004

Net asset value, beginning of year	\$ 1,262,690,838	\$ 1,272,660,299
Value of units purchased by participants	68,871,431	67,599,046
Value of units sold by participants	(17,143,652)	(9,509,724)
Changes in fair value of investments managed	<u>16,421,884</u>	<u>(68,058,783)</u>
<b>Net asset value, end of year</b>	<b>\$ <u>1,330,840,501</u></b>	<b>\$ <u>1,262,690,838</u></b>

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004

Interest income (Note 2)	\$ 67,804,006	\$ 68,116,393
Amortization/accretion	5,102,743	6,403,105
Net realized gains (Note 2)	12,452,243	12,315,173
Security lending income	3,217,273	1,510,514
Security lending expense	(3,040,824)	(1,334,702)
Administrative expenses	(218,667)	(203,928)
Income due participants, beginning of year	<u>8,651,899</u>	<u>7,509,196</u>
<b>Income available for distribution</b>	<b>93,968,673</b>	<b>94,315,751</b>
<b>Distribution</b>	<b><u>85,740,153</u></b>	<b><u>85,663,852</u></b>
<b>Income due participants, end of year (Note 2)</b>	<b>\$ <u>8,228,520</u></b>	<b>\$ <u>8,651,899</u></b>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS  
TRUST FUNDS BOND POOL**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**1. HISTORY AND ORGANIZATION**

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Trust Funds Bond Pool (TFBP) was created by the Board to allow qualifying funds, per section 17-6-201, MCA, to participate in a diversified pool. The TFBP was created on October 1, 1995, by the transfer of all fixed income and variable-rate securities owned by six funds. These funds included the 1) Coal Severance Tax Permanent Trust, 2) Resource Indemnity Trust, 3) Coal Tax Park Trust, 4) Trust and Legacy, 5) Coal Tax Cultural Trust and 6) Treasure State Endowment Trust funds. Since the pool's creation in 1995, the funds listed below became participants in the TFBP:

**Note 1. HISTORY AND ORGANIZATION**

University of Montana Endowment Fund*	January 1996
Montana Pole Superfund	September 1996
Upper Clark Fork River Basin (UCFRB) Restoration	July 1999
Upper Clark Fork River Basin (UCFRB) Cost Recovery	July 1999
Streamside Tailings Operable Unit	July 1999
Treasure State Regional Water Systems	July 2000
Tobacco Trust Fund	January 2001
University of Montana Designated Fund*	July 2002
University of Montana Other Fund*	July 2002
Montana Tech of the U of M	March 2003
Real Property Trust	September 2003
Wildlife Habitat	September 2003
Acquisition Trust	April 2004
Bair Trust Fund	April 2004
Bradley Trust	April 2004
Merritt Wheeler Trust	April 2004
Sobotka Memorial Trust	April 2004
Teakle Trust	April 2004
Montana State University	July 2004

\*In October 2003, the University of Montana Other Fund withdrew from the TFBP. In July 2005, the University of Montana requested the University of Montana Endowment Fund and the University of Montana Designated Fund be closed and transferred, at cost, into the University of Montana Other Fund.

Per House Bill 249, the Big Sky Economic Development Fund became the newest TFBP participant on July 1, 2005.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Investments**

The TFBP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The TFBP portfolio includes securities classified as corporate, foreign government bonds, municipals, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

The TFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as U.S. government indirect-backed securities in

the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 9 for the Year End Portfolio)

TFBP fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The TFBP variable-rate securities float with LIBOR (London Interbank Offered Rate). As of June 30, 2005, three variable-rate securities, with a total amortized cost of \$29,000,000, are identified and reported as corporate or U.S. government indirect-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 9 for the Year End Portfolio.) The TFBP did not hold any variable rate securities as of June 30, 2004.

Investments are presented in the Statement of Net Asset Value at fair value. Fair values for securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

The TFBP, as an internal investment pool, invests its excess cash in the Board's Short Term Investment Pool, (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

#### Participant Units

The Coal Severance Tax Permanent Trust, Resource Indemnity Trust, Coal Tax Park Trust, Trust and Legacy, Coal Tax Cultural Trust, and Treasure State Endowment Trust funds transferred all fixed income and variable-rate securities, at amortized cost, into the TFBP at the start-up date and were issued units according to the fair value of each participant's portfolio. The initial unit value as of October 1, 1995, was \$100.00. Unit values are calculated weekly and at month end, based on portfolio pricing, to allow for participant transactions to occur as determined by the investment staff.

The June 30, 2005 unit value of \$101.35 increased from a June 30, 2004 unit value of \$100.03. The yield on longer term bonds decreased during the fiscal year, which has the effect of increasing bond prices and the pool unit value. A one percent (1%) change in interest rates is expected to have a four to six percent (4%-6%) inverse change in the unit value. TFBP investments are considered long-term in nature and participants require long-term time horizons.

#### Broker Receivable/Payable

TFBP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the TFBP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

#### Other

Accumulated income, recorded as Income Due Participants, is distributed monthly on the first calendar day of each month. Realized portfolio gains/losses are distributed at least annually to the participants.

Interest income reported in the Statement of Investment Income and Distribution includes interest accruals and miscellaneous income.

Administrative expenses incurred by the Board are charged daily to TFBP based on the Board's expenses applicable to TFBP. These expenses include costs for the custodial bank contract.

### **3. SECURITIES LENDING**

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2005 and 2004, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2005 and 2004 on the amount of the loans that State Street Bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2005 and 2004. Moreover, there were no losses during fiscal years 2005 and 2004 resulting from a default of the borrowers or State Street Bank.

During fiscal years 2005 and 2004, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 35 and 49 days, respectively as of June 30, 2005 and 2004. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2005, the carrying and fair value of the underlying securities on loan for the Trust Funds Bond Pool was \$151,184,341 and \$157,922,586, respectively. The collateral provided for the securities on loan totaled \$162,631,521 representing \$159,415,025 in cash and \$3,216,496 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$20,985,615 corporate, \$2,628,923 foreign government bonds, \$52,176,907 U.S. government direct-backed, and \$75,392,895 U.S. government indirect-backed.

As of June 30, 2004, the carrying and fair value of the underlying securities on loan for the Trust Funds Bond Pool was \$164,208,920 and \$172,167,230, respectively. The collateral provided for the securities on loan totaled \$177,281,934 representing \$174,252,479 in cash and \$3,029,455 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$13,195,489 corporate, \$3,990,926 foreign government bonds, \$14,449,754 U.S. government direct-backed, and \$132,572,751 U.S. government indirect-backed.

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The financial statement disclosures for the year ended June 30, 2004 have been restated to compare with the financial statement disclosures for the year ended June 30, 2005. The investment risk disclosures are described in the following paragraphs.

##### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the TFBP fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires TFBP fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the table below are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all the fixed income securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The State Street repurchase agreement was purchased in the State of Montana Board of Investments name.

##### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement. According to the TFBP Investment Policy, "with the exception of U.S. government indirect-backed (agency) securities, additional TFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". As of June 30, 2005, the TFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 8.19%. As of June 30, 2004, there were no single issuer investments that exceeded 5% of the TFBP portfolio.

## Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The TFBP investment policy does not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs and ARMs)."

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

As reported in the U.S. government indirect-backed category, the TFBP portfolio holds REMICs totaling \$113,944 and \$429,878, respectively, at amortized cost, as of June 30, 2005 and June 30, 2004. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

The TFBP holds one inverse variable rate corporate \$15 million par bond. The quarterly coupon is calculated at a set rate less the 12 month LIBOR in arrears. As interest rates increase, the coupon paid will decline.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2005 and June 30, 2004. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

### **Credit Quality Rating and Effective Duration as of June 30, 2005**

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Corporate Bonds (Rated)	\$ 665,536,568	A-	5.42
Corporate Bonds (Unrated)	5,956,312	NR	2.12
Foreign Government Bonds	10,435,000	BBB	6.67
Municipal Government Bonds (Unrated)	6,123,270	NR	2.58
U.S. Government Direct-Backed	120,326,386	AAA	6.14
U.S. Government Indirect-Backed	455,262,802	AAA	3.86
State Street Repurchase Agreement* (Rated)	3,307,867	AA-	NA
Short Term Investment Pool (STIP)	<u>64,746,933</u>	<u>NR</u>	NA
 Total Investments	 \$ <u>1,331,695,138</u>	 <u>AA-</u>	 <u>4.91</u>
 Securities Lending Collateral Investment Pool	 \$ <u>159,415,025</u>	 NR	 NA

\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at \$3,389,890 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

**Credit Quality Rating and Effective Duration as of June 30, 2004**

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Corporate Bonds (Rated)	\$ 667,384,491	A-	6.01
Corporate Bonds (Unrated)	7,867,682	NR	2.82
Foreign Government Bonds	9,610,000	BBB-	6.96
Municipal Government Bonds (Unrated)	9,894,283	NR	2.77
U.S. Government Direct-Backed	94,022,947	AAA	8.47
U.S. Government Indirect-Backed	439,171,293	AAA	6.71
Short Term Investment Pool (STIP)	<u>44,503,715</u>	<u>NR</u>	NA
 Total Investments	 \$ <u>1,272,454,411</u>	 <u>AA-</u>	 <u>6.41</u>
 Securities Lending Collateral Investment Pool	 \$ <u>174,252,479</u>	 NR	 NA

**Specific Legal and Credit Risk**

As of June 30, 2005, Delta Airlines Corp. presented a higher credit risk to the Board. The TFBP holds a \$2 million par 10.0% Delta Airlines Corp. bond maturing June 5, 2013 and a \$3 million par 10.14% Delta Airlines Corp. bond maturing August 14, 2012. Due to a weak credit outlook and potential bankruptcy, the Board stopped the interest income accruals after the December 2004 and February 2005 pay dates. Although the interest accruals were stopped, the Board received the interest due in June 2005 and August 2005. The combined book value of these securities was \$4,994,602 as of June 30, 2005. Due to the company's filing for Chapter 11 bankruptcy protection on September 14, 2005, the book values were reduced to \$1 million and \$1.5 million, respectively.

As of June 30, 2005, Northwest Airlines Inc. presented a higher credit risk to the Board. The TFBP held a \$10,757,539 par 6.81% Northwest Airlines Inc. bond maturing February 1, 2020, a \$3,901,307 par 7.935% Northwest Airlines Inc. MBIA Insurance Corp insured bond maturing April 1, 2019 and a \$9,255,000 par 4.64% Northwest Airlines Inc. real estate backed bond maturing July 7, 2010. The combined book value of these securities was \$23,611,399 as of June 30, 2005. On September 14, 2005, the company filed for Chapter 11 bankruptcy protection. Due to this action, the Board stopped the interest income accruals for the 6.81% bond maturing February 1, 2020 after the August 2005 pay date. This issue was sold on September 20, 2005 generating a loss of \$809,221. The sale included accrued interest from August 1, 2005 to September 20, 2005. Since the 7.935% bond maturing April 1, 2019 is insured by MBIA Insurance Corp. to support the payment of any interest due and outstanding principal balance, the Board did not stop the interest income accrual or reduce book value. The 4.64% bond maturing July 7, 2010 is secured by Northwest Airlines Inc.'s corporate headquarters building and land.

As of June 30, 2005 and June 30, 2004, Burlington Industries, Inc. presented a legal and higher credit risk to the Board. The Board owns a Burlington Industries, Inc., \$4 million par, 7.25% bond maturing September 15, 2005. In September 2000, the company announced a reduction of stockholders equity. Due to an increasing senior bank line and declining credit trend, the bond ratings for this issue were downgraded, in May 2001, by the Moody's and Standard & Poor's rating agencies. During fiscal year 2001, the book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of \$3,739,760 to \$1,600,000. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to \$800,000. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the Board received \$969,974 in August 2004 for its unsecured claim. This transaction reduced the book value to \$0 and generated a gain of \$169,974. In February 2005 and May 2005, the Board received an additional \$139,180 and \$129,498, respectively, for its unsecured claim. The Board is expected to receive additional claim proceeds over the next two to three years.

As of June 30, 2004, Winn Dixie presented a higher credit risk to the Board. The TFBP held a Winn Dixie Trust, \$64.509 million par, zero coupon bond maturing September 1, 2024. Due to a weak credit outlook and collateral uncertainty, the Board stopped accruing income and reduced the book value to \$4.8 million in February 2004. On February 21, 2005, Winn Dixie declared bankruptcy. On February 28, 2005, the Board sold the bond and recorded a \$4.231 million gain.

## 5. PARTICIPANT LOAN

In accordance with Senate Bill 495 enacted by the 2001 Legislature, the Coal Severance Tax Permanent Trust loaned 483,604 TFBP shares, with a book value of \$46,366,904, to the Trust and Legacy fund on July 2, 2001. The loan proceeds were deposited in the Trust and Legacy Fund. A loan receivable was recorded in the Coal Severance Tax Permanent Trust and a corresponding liability was recorded in the Guarantee Fund, a General Fund sub-fund. The August 2002 Special Legislative Session approved the request to record this activity in a state special revenue fund of the Office of Public Instruction rather than in the Guarantee Fund. In 2005, the Trust and Legacy Fund paid principal of \$2,650,063 to the Coal Severance Tax Permanent Trust reducing the TFBP shares on loan to 436,973 TFBP shares with a corresponding book value of \$41,896,024.

## 6. DEUTSCHE BANK SECURITIES, INC. COMPLAINT

The Board received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$8 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$861,811 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The Board tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of \$113.099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the Board received \$9,092,920 in principal and interest plus \$240,000 as a consent fee. As of September 23, 2005, this matter is still pending.

## 7. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

The trading system will serve the Board's internally managed portfolios and will be phased in as training is completed. Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Electronic trading for the Short Term Investment Pool will be next followed by the other fixed income portfolios managed by Board Staff.

## 8. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 9. YEAR END PORTFOLIO

The June 30, 2005 TFBP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>%</u>
STATE STREET REPURCHASE AGREEMENT	2.250	07/01/05	3,307,867	3,307,867	3,307,867	0.25%
SHORT TERM INVESTMENT POOL			64,746,933	64,746,933	64,746,933	4.86%
<b>Cash Equivalents</b>	<b>2 Issue(s)</b>		<b>68,054,800</b>	<b>68,054,800</b>	<b>68,054,800</b>	<b>5.11%</b>
AA / FT WORTH HQ FINANCIAL TRUST	5.500	10/05/10	10,303,757	10,303,757	10,026,586	0.75%
AERO 1 HQ FINANCE TRUST	4.640	07/07/10	9,255,000	9,255,000	9,044,079	0.68%



Security Name	Coupon	Maturity	Par	Book Value	Fair Value	%
AMERICA WEST AIRLINES EQUIPMENT TRUST	7.930	01/02/19	3,171,130	3,171,130	3,507,745	0.26%
AMERICAN AIRLINES 1991 EQUIPMENT TRUST	9.730	09/29/14	5,000,000	4,981,617	3,500,000	0.26%
AMERICAN AIRLINES EQUIPMENT TRUST	6.977	05/23/21	5,710,754	5,699,518	5,253,894	0.39%
AMERICAN EXPRESS CO	4.750	06/17/09	2,000,000	1,997,353	2,040,626	0.15%
AMERICAN GEN FINANCIAL CORP	4.625	05/15/09	4,000,000	4,014,828	4,020,448	0.30%
ARCHER DANIELS MIDLAND CO	10.250	01/15/06	5,000,000	4,999,064	5,178,102	0.39%
BANK ONE TEXAS NA	6.250	02/15/08	4,000,000	3,914,200	4,200,769	0.32%
BANKBOSTON NA	6.375	03/25/08	4,000,000	3,917,974	4,228,864	0.32%
BAYERISCHE LANDESBANK	VAR	09/27/11	15,000,000	15,000,000	15,000,000	1.13%
BELLSOUTH CORP	4.750	11/15/12	3,000,000	2,993,251	3,015,747	0.23%
BELLSOUTH TELECOMM INC	6.300	12/15/15	10,100,850	11,001,321	10,799,687	0.81%
BISHOPSGATE CDO LTD	5.180	06/30/10	10,000,000	10,000,000	10,000,000	0.75%
BORG WARNER AUTOMOTIVE INC	7.000	11/01/06	1,000,000	1,004,895	1,035,937	0.08%
BURLINGTON INDUSTRIES INC	7.250	09/15/05	4,000,000	0	40	0.00%
BURLINGTON NORTHERN CO EQUIPMENT TRUST	7.970	01/01/15	3,533,016	3,533,016	4,349,425	0.33%
BURLINGTON NORTHERN SANTA FE EQUIP TRST	7.160	01/02/20	13,120,569	13,120,569	15,057,638	1.13%
CIT GROUP EQUIPMENT TRUST	6.490	01/05/21	11,006,787	11,006,787	12,173,399	0.91%
CIT GROUP INC	7.375	04/02/07	5,000,000	5,205,136	5,267,745	0.40%
CIT GROUP INC	4.750	12/15/10	3,000,000	3,105,369	3,034,674	0.23%
CNA FINANCIAL CORP	6.450	01/15/08	5,000,000	5,034,407	5,226,340	0.39%
CSX CORP	7.450	05/01/07	2,000,000	1,999,446	2,116,906	0.16%
CSX CORP	7.900	05/01/17	4,588,000	4,586,425	5,848,013	0.44%
CANADIAN NATIONAL RAILWAY CO	6.800	07/15/18	4,000,000	3,982,162	4,782,958	0.36%
CAPITAL ONE BANK	5.000	06/15/09	4,000,000	3,994,021	4,087,068	0.31%
CENTEX CORP	4.550	11/01/10	6,000,000	5,991,670	5,928,954	0.45%
CHAMPION INTERNATIONAL CORP	7.150	12/15/27	3,000,000	2,942,511	3,523,932	0.26%
CHICAGO + NORTH WESTERN RY	8.910	01/01/15	3,899,471	3,899,471	4,674,626	0.35%
CITIGROUP INC	6.200	03/15/09	5,000,000	4,870,922	5,343,475	0.40%
CITICORP CAPITAL II	8.015	02/15/27	6,000,000	5,957,562	6,581,803	0.49%
CLEVELAND ELECTRIC ILLUM CO	7.130	07/01/07	5,000,000	4,994,668	5,265,120	0.40%
CONAGRA INC	9.875	11/15/05	5,000,000	5,025,797	5,119,405	0.38%
CONTINENTAL AIRLINES EQUIPMENT TRUST	6.545	02/02/19	5,766,300	5,766,300	5,578,895	0.42%
CORPORATE PROPERTY REIT	7.875	03/15/16	3,000,000	2,994,404	3,644,495	0.27%
COX COMMUNICATIONS INC	4.625	01/15/10	5,000,000	4,995,354	4,986,800	0.37%
DOT HEADQUARTERS II LEASE MTG	1.000	12/07/21	20,000,000	17,174,535	17,804,600	1.34%
DEER PARK REFINING L P	6.470	12/15/08	2,074,850	2,056,032	2,153,748	0.16%
DELTA AIR LINES INC EQUIPMENT TRUST	10.140	08/14/12	1,000,000	1,000,000	425,000	0.03%
DELTA AIR LINES INC EQUIPMENT TRUST	10.140	08/14/12	2,000,000	1,994,602	850,000	0.06%
DELTA AIR LINES INC EQUIPMENT TRUST	10.000	06/05/13	2,000,000	2,000,000	860,000	0.06%
EASTERN ENERGY LTD	7.250	12/01/16	10,000,000	9,897,332	12,381,664	0.93%
ENTERGY ARKANSAS INC	4.500	06/01/10	5,000,000	4,978,236	5,000,978	0.38%
FIRST CHICAGO CORP	6.375	01/30/09	4,000,000	3,861,834	4,286,644	0.32%
FIRST UNION BANK N C CHARLOTTE	5.800	12/01/08	4,000,000	3,846,883	4,209,364	0.32%
FLORIDA GAS TRANSMISSION CO	9.190	11/01/24	5,000,000	5,000,000	6,363,263	0.48%
FLORIDA GAS TRANSMISSION CO	7.000	07/17/12	3,000,000	2,996,936	3,348,980	0.25%
FORD MOTOR CREDIT CO	7.375	10/28/09	7,000,000	7,004,944	6,912,809	0.52%
FORD MOTOR CREDIT CO	7.000	10/01/13	5,000,000	4,884,854	4,797,395	0.36%
FORD MOTOR CREDIT CO	5.700	01/15/10	3,000,000	2,973,529	2,762,204	0.21%
GTE CORP	7.900	02/01/27	6,000,000	6,000,000	6,524,178	0.49%
GTE SOUTH INC	7.500	03/15/26	6,000,000	5,927,879	6,317,629	0.47%
GALENA CDO TRUST	VAR	01/11/13	9,000,000	9,000,000	9,000,000	0.68%
GENERAL AMERICAN TRANSN CORP EQUIPMENT TR	8.420	01/01/15	7,444,367	7,444,367	8,582,520	0.64%
GENERAL MOTORS ACCEPTANCE CORP	6.125	08/28/07	5,000,000	5,008,377	4,937,581	0.37%
GENERAL MOTORS ACCEPTANCE CORP	6.875	08/28/12	15,000,000	12,952,221	13,704,203	1.03%
GENERAL MOTORS ACCEPTANCE CORP	5.625	05/15/09	4,000,000	4,074,231	3,716,942	0.28%
HOUSEHOLD FINANCE CORP	6.875	03/01/07	3,000,000	2,982,578	3,136,930	0.24%
HOUSEHOLD FINANCE CORP	6.500	11/15/08	5,000,000	4,895,867	5,345,256	0.40%
IBP FINANCIAL CO CANADA	7.450	06/01/07	3,000,000	2,999,603	3,124,710	0.23%
ING SECURITY LIFE INSTITUTIONAL FUNDING	4.250	01/15/10	5,000,000	4,990,068	4,986,440	0.37%
ILLINOIS BELL TELEPHONE CO	6.625	02/01/25	2,000,000	1,814,963	2,030,414	0.15%

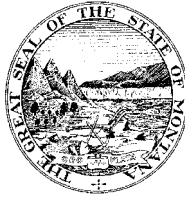
Security Name	Coupon	Maturity	Par	Book Value	Fair Value	%
INTERNATIONAL LEASE FINANCE CORP	4.550	10/15/09	3,000,000	3,010,129	3,027,645	0.23%
INTERNATIONAL PAPER CO	6.875	11/01/23	2,000,000	1,978,190	2,230,086	0.17%
INTERNATIONAL PAPER CO	4.000	04/01/10	6,000,000	5,999,827	5,798,442	0.44%
J P MORGAN CAPITAL TRUST	7.540	01/15/27	4,000,000	3,802,399	4,304,119	0.32%
J P MORGAN CHASE COMMERCIAL MORTGAGE TRST	4.555	06/12/41	8,000,000	7,999,922	8,063,182	0.61%
J P MORGAN CHASE COMMERCIAL MORTGAGE TRST	3.053	01/15/38	8,017,116	8,040,081	7,802,312	0.59%
KCT INTERMODAL TRANSPORTATION CORP	6.884	08/01/18	1,736,267	1,736,267	1,925,662	0.14%
KELLWOOD CO	7.625	10/15/17	8,000,000	7,925,694	8,591,240	0.65%
KERR MCGEE CORP	7.125	10/15/27	3,000,000	3,035,091	3,108,750	0.23%
KERR MCGEE CORP	6.950	07/01/24	3,000,000	2,977,826	3,099,819	0.23%
KEYCORP	4.700	05/21/09	5,000,000	4,999,495	5,079,160	0.38%
LEHMAN BROTHERS HOLDINGS INC	3.950	11/10/09	5,000,000	4,991,309	4,930,715	0.37%
MACMILLAN BLOEDEL LTD	7.700	02/15/26	5,000,000	4,897,976	6,019,076	0.45%
MARSH + MCLENNAN COS INC	7.125	06/15/09	5,000,000	5,048,227	5,409,267	0.41%
MEAD CORP	7.350	03/01/17	4,000,000	3,997,395	4,727,269	0.35%
MED MAP L L C MONTANA	7.060	12/01/15	4,260,000	4,260,000	4,260,000	0.32%
MED MAP L L C MONTANA	7.000	06/01/21	4,570,000	4,570,000	4,570,000	0.34%
METLIFE INC	5.000	11/24/13	5,000,000	4,959,645	5,086,030	0.38%
METROPOLITAN LIFE GOLBAL MTN	4.250	07/30/09	2,000,000	1,999,186	2,006,936	0.15%
MILLENIUM AMERICAN INC	7.000	11/15/06	1,000,000	995,860	1,028,750	0.08%
MOBIL CORP	5.940	01/15/19	8,422,738	8,422,738	9,190,754	0.69%
MORGAN J P + CO INC	0.000	04/15/27	70,000,000	13,582,834	13,497,463	1.01%
NATIONWIDE FINANCIAL SERVICES INC	8.000	03/01/27	4,000,000	3,945,667	4,355,873	0.33%
NORFOLK SOUTHERN CORP	7.700	05/15/17	4,000,000	4,011,666	5,002,933	0.38%
NORTHWEST AIRLINES EQUIPMENT TRUST	6.810	02/01/20	10,757,539	10,494,411	9,291,825	0.70%
NORTHWEST AIRLINES EQUIPMENT TRUST	7.935	04/01/19	3,901,307	3,861,988	4,242,671	0.32%
OCCIDENTAL PETROLEUM CORP	7.200	04/01/28	7,000,000	6,883,046	8,713,520	0.65%
OCCIDENTAL PETROLEUM CORP	8.750	01/15/23	4,000,000	4,000,000	5,594,498	0.42%
OLD REPUBLIC INTERNATIONAL CORP	7.000	06/15/07	3,000,000	2,999,683	3,159,126	0.24%
PNC FUNDING CORP	4.200	03/10/08	5,000,000	4,997,892	5,001,510	0.38%
PPL MONTANA LLC	8.903	07/02/20	20,561,686	20,642,287	24,630,834	1.85%
PACIFIC BELL	7.250	11/01/27	4,000,000	3,974,880	4,285,632	0.32%
PANAMERICAN BEVERAGES INC	7.250	07/01/09	7,000,000	6,988,829	7,631,257	0.57%
PHILLIPS PETROLEUM CO	7.125	03/15/28	4,000,000	3,947,727	4,341,499	0.33%
SECURITY CAP GROUP INC	7.700	06/15/28	2,000,000	2,336,632	2,673,099	0.20%
SONAT INC	7.000	02/01/18	2,000,000	1,999,809	1,850,000	0.14%
SOUTHERN UNION CO	7.600	02/01/24	8,000,000	7,455,669	9,803,402	0.74%
SOUTHWEST GAS CORP	7.500	08/01/06	4,000,000	4,084,273	4,140,343	0.31%
SOUTHWEST GAS CORP	8.375	02/15/11	8,000,000	8,006,764	9,370,346	0.70%
SOUTHWESTERN BELL TEL CO	7.000	11/15/27	2,000,000	1,997,942	2,124,240	0.16%
SUNAMERICA INC	8.125	04/28/23	7,000,000	7,036,596	9,365,593	0.70%
SUPERVALU INC	7.875	08/01/09	7,000,000	6,990,999	7,803,344	0.59%
TEXAS GAS TRANSMISSION CORP	7.250	07/15/27	2,000,000	1,852,989	2,502,792	0.19%
TRANSCONTINENTAL GAS PIPE LINE	7.250	12/01/26	2,000,000	2,010,467	2,160,000	0.16%
TRISTATE GENERATION TRANSPORTATION ASSOC	6.040	01/31/18	7,000,000	7,051,962	7,274,890	0.55%
TYSON FOODS INC	8.250	10/01/11	5,000,000	5,503,390	5,902,618	0.44%
ULTRAMAR DIAMOND SHAMROCK CORP	7.200	10/15/17	2,000,000	1,988,642	2,275,485	0.17%
UNION PACIFIC RESOURCES GROUP INC	7.050	05/15/18	6,000,000	5,945,070	6,861,012	0.52%
UNION TANK CAR CO	7.125	02/01/07	2,000,000	1,999,661	2,091,435	0.16%
UNION TANK CAR CO	7.450	06/01/09	5,000,000	5,000,000	5,540,716	0.42%
WASHINGTON MUTUAL INC	4.200	01/15/10	6,000,000	5,991,777	5,952,048	0.45%
WESTERN PROPERTIES TRUST	7.200	09/15/08	1,000,000	981,031	1,081,054	0.08%
WESTVACO CORP	7.650	03/15/27	6,000,000	5,977,684	7,156,826	0.54%
WEYERHAEUSER CO	8.500	01/15/25	8,000,000	9,183,753	10,309,028	0.77%
WILLAMETTE INDUSTRIES INC	7.000	02/01/18	1,000,000	942,772	1,106,000	0.08%
XANTERRA SOUTH RIM LLC	5.690	12/15/11	8,000,000	8,000,000	8,000,000	0.60%
ZIONS BANCORPORATION	5.650	05/15/14	3,000,000	2,952,133	3,176,796	0.24%
<b>Corporate Bonds (Rated)</b>	<b>119 Issue(s)</b>		<b>689,201,505</b>	<b>624,287,960</b>	<b>665,536,568</b>	<b>49.98%</b>
FIRST INTERSTATE BANC SYSTEM MONTANA	7.500	10/01/06	2,670,000	2,670,000	2,670,000	0.20%
WILMINGTON TRUST TUCSON ELECTRIC	10.211	01/01/09	3,286,312	3,286,312	3,286,312	0.25%

Security Name	Coupon	Maturity	Par	Book Value	Fair Value	%
<b>Corporate Bonds (Unrated)</b>	<b>2 Issue(s)</b>		<b>5,956,312</b>	<b>5,956,312</b>	<b>5,956,312</b>	<b>0.45%</b>
UNITED MEXICAN STATES	5.875	01/15/14	10,000,000	9,924,211	10,435,000	0.78%
<b>Foreign Government Bonds</b>	<b>1 Issue(s)</b>		<b>10,000,000</b>	<b>9,924,211</b>	<b>10,435,000</b>	<b>0.78%</b>
BUTTE SILVER BOW MONTANA TAX INDL	6.890	07/01/05	1,535,000	1,535,000	1,535,000	0.12%
MONTANA STATE TAXABLE RENEW (3 ISSUES)	7.35-7.40	08/01/09-12	420,000	419,219	420,000	0.03%
MONTANA STATE BOARD HOUSING	8.450	08/01/39	1,140,000	1,140,000	1,140,000	0.09%
CRP (69 issues)	6.00-8.00	11/15/05-15	3,028,270	3,028,270	3,028,270	0.23%
<b>Municipal Government Bonds (Unrated)</b>	<b>74 Issue(s)</b>		<b>6,123,270</b>	<b>6,122,489</b>	<b>6,123,270</b>	<b>0.46%</b>
BENDER SHIPBUILDING + REPAIR USGG XI	6.200	09/30/12	9,957,643	9,957,643	9,957,643	0.75%
GLOBAL INDUSTRIES LTD USGG XI	7.710	02/15/25	8,000,000	8,000,000	8,000,000	0.60%
REINAUER MARITIME CO LLC USGG XI	6.500	06/30/28	18,952,000	18,952,000	18,952,000	1.42%
T T BARGE SERVICES USGG XI	6.450	12/16/12	1,528,500	1,528,500	1,528,500	0.11%
TUNISIA AID USGG XI	6.710	02/01/24	3,900,522	3,721,376	3,900,522	0.29%
VESSEL MANAGEMENT SERVICES INC USGG XI	6.080	05/20/24	18,472,000	18,472,000	20,400,107	1.53%
GNMA POOL 032974	9.500	09/15/09	23,905	23,109	25,461	0.00%
GNMA POOL 038164	10.000	01/15/10	60,728	60,598	65,988	0.00%
GNMA POOL 039321	10.000	12/15/09	16,332	16,298	17,728	0.00%
GNMA POOL 042547	10.000	10/15/10	4,192	4,182	4,583	0.00%
GNMA POOL 065459	11.500	04/15/13	5,352	5,305	6,213	0.00%
GNMA POOL 281467	9.000	09/15/19	8,469	8,439	9,430	0.00%
UNITED STATES TREASURY BONDS	7.250	05/15/16	14,000,000	14,411,895	17,937,500	1.35%
UNITED STATES TREASURY NOTES	3.000	02/15/09	10,000,000	9,731,017	9,766,410	0.73%
UNITED STATES TREASURY NOTES	2.750	06/30/06	20,000,000	20,048,063	19,846,100	1.49%
UNITED STATES TREASURY NOTES	3.000	12/31/06	10,000,000	9,965,678	9,908,200	0.74%
<b>U.S. Government Direct-Backed</b>	<b>16 Issue(s)</b>		<b>114,929,643</b>	<b>114,906,104</b>	<b>120,326,386</b>	<b>9.04%</b>
FEDERAL HOME LOAN MORTGAGE CORP	5.125	11/07/13	12,000,000	11,930,845	12,045,696	0.90%
FEDERAL HOME LOAN MORTGAGE CORP	5.000	06/18/18	20,000,000	20,000,000	19,730,720	1.48%
FEDERAL HOME LOAN MORTGAGE CORP	4.000	06/12/13	12,000,000	11,076,622	11,667,600	0.88%
FEDERAL HOME LOAN MORTGAGE CORP	4.000	07/18/18	15,000,000	15,000,000	14,694,932	1.10%
FEDERAL HOME LOAN MORTGAGE CORP	4.500	04/02/14	9,000,000	8,968,485	8,914,860	0.67%
FEDERAL HOME LOAN MORTGAGE CORP	4.100	01/28/14	30,000,000	30,000,000	29,923,770	2.25%
FEDERAL HOME LOAN MORTGAGE CORP	5.000	01/30/14	12,000,000	11,996,599	12,032,244	0.90%
FEDERAL HOME LOAN MORTGAGE CORP	0.000	06/21/32	100,000,000	15,631,516	16,220,000	1.22%
FEDERAL HOME LOAN MORTGAGE CORP	8.250	06/01/26	7,000,000	7,263,142	9,974,370	0.75%
FEDERAL HOME LOAN MORTGAGE CORP	0.000	06/05/28	50,000,000	10,534,017	11,066,550	0.83%
FEDERAL HOME LOAN MORTGAGE CORP	0.000	09/14/29	100,000,000	19,270,393	20,532,500	1.54%
FEDERAL HOME LOAN MORTGAGE CORP	3.500	09/15/07	20,000,000	20,185,778	19,877,180	1.49%
FEDERAL HOME LOAN PC REMIC	9.150	10/15/20	115,137	113,944	115,029	0.01%
FEDERAL HOME LOAN POOL B13150	4.000	03/01/19	17,034,459	17,034,459	16,680,013	1.25%
FEDERAL HOME LOAN POOL C01523	5.000	03/01/33	7,290,235	7,231,281	7,314,156	0.55%
FEDERAL HOME LOAN POOL E00247	5.500	10/01/08	370,224	369,579	380,275	0.03%
FEDERAL HOME LOAN POOL E00659	6.000	04/01/14	926,595	926,017	959,568	0.07%
FEDERAL HOME LOAN POOL E01376	4.000	04/01/18	15,858,753	15,748,264	15,541,578	1.17%
FEDERAL HOME LOAN POOL E01418	4.000	07/01/18	15,934,525	15,408,301	15,602,965	1.17%
FEDERAL HOME LOAN POOL E01425	4.500	08/01/18	16,061,644	16,021,887	16,001,978	1.20%
FEDERAL HOME LOAN POOL E99081	4.500	09/01/18	17,450,577	17,351,017	17,385,751	1.31%
FEDERAL HOME LOAN POOL G10173	6.000	01/01/09	307,458	307,097	318,207	0.02%
FEDERAL HOME LOAN POOL G10814	5.500	05/01/13	651,358	650,974	670,670	0.05%
FEDERAL HOME LOAN POOL G11670	4.000	03/01/15	14,274,120	14,044,597	13,977,889	1.05%
FEDERAL HOME LOAN POOL G30006	7.000	07/01/13	373,627	373,627	389,908	0.03%
FEDERAL HOME LOAN BANKS	6.395	06/03/14	6,000,000	5,656,708	6,890,655	0.52%
FEDERAL HOME LOAN BANKS	7.000	08/26/19	7,000,000	6,965,352	8,912,169	0.67%
FEDERAL HOME LOAN BANKS	7.450	02/03/20	10,000,000	10,059,677	13,283,650	1.00%
FEDERAL HOME LOAN BANKS	4.125	08/13/10	15,000,000	15,159,535	15,031,455	1.13%
FEDERAL HOME LOAN BANKS	5.000	08/28/19	10,000,000	10,000,000	10,000,000	0.75%
FEDERAL HOME LOAN BANKS	VAR	05/26/10	5,000,000	5,000,000	4,997,880	0.38%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	6.000	05/15/08	15,000,000	14,812,526	15,853,052	1.19%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	7.250	01/15/10	15,000,000	14,965,534	17,003,682	1.28%

<b>Security Name</b>	<b>Coupon</b>	<b>Maturity</b>	<b>Par</b>	<b>Book Value</b>	<b>Fair Value</b>	<b>%</b>
FEDERAL NATIONAL MORTGAGE ASSOCIATION	2.800	03/01/19	7,000,000	6,946,434	6,955,473	0.52%
FNMA POOL 254233	5.000	03/01/17	6,753,336	6,560,710	6,847,513	0.51%
FNMA POOL 254631	5.000	02/01/18	8,330,567	8,404,120	8,433,717	0.63%
FNMA POOL 303202	6.500	05/01/14	1,233,736	1,224,846	1,278,231	0.10%
FNMA POOL 313999	6.000	02/01/13	457,287	455,554	473,632	0.04%
FNMA POOL 572220	6.000	03/01/16	1,031,888	1,029,472	1,068,125	0.08%
FNMA POOL 592327	5.500	06/01/16	1,602,666	1,571,933	1,649,056	0.12%
FNMA POOL 725346	4.000	03/01/19	17,500,311	17,325,247	17,166,718	1.29%
FNMA POOL 780956	4.500	05/01/19	17,768,954	17,763,724	17,701,978	1.33%
U S ARMY HOSPITALITY FUND	7.467	05/01/32	9,697,407	9,697,407	9,697,407	0.73%
<b>U.S. Government Indirect-Backed</b>	<b>43 Issue(s)</b>		<b>648,024,864</b>	<b>441,037,218</b>	<b>455,262,802</b>	<b>34.19%</b>
<b>Total TFBP</b>	<b>257 Issue(s)</b>		<b>1,542,290,393</b>	<b>1,270,289,093</b>	<b>1,331,695,138</b>	<b>100.00%</b>

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Short Term Investment Pool, as of June 30, 2005, and 2004, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Short Term Investment Pool, as of June 30, 2005, and 2004, and its changes in net asset value and investment income and distribution for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

**STATE OF MONTANA BOARD OF INVESTMENTS  
SHORT TERM INVESTMENT POOL FINANCIAL STATEMENTS**

**STATEMENT OF NET ASSET VALUE JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<u>Assets</u>		
Cash	\$ 528,828	\$ 203,235
Interest receivable	1,385,382	403,650
Security lending cash collateral (Notes 3 and 4)	0	0
Unrealized loss (Note 2)	435,083	37,638
Investments managed at fair value (amortized cost of \$1,742,735,519 in 2005 and \$1,479,812,941 in 2004)(Notes 2 and 4)	<u>1,742,300,436</u>	<u>1,479,775,303</u>
<b>Total assets</b>	<b>\$ <u>1,744,649,729</u></b>	<b>\$ <u>1,480,419,826</u></b>
<u>Liabilities</u>		
Security lending expense payable	\$ 0	\$ 0
Income due participants	528,829	203,236
Broker payable for securities purchases but not settled (Note 2)	3,000,000	0
Security lending obligations(Notes 3 and 4)	<u>0</u>	<u>0</u>
<b>Total liabilities</b>	<b>\$ <u>3,528,829</u></b>	<b>\$ <u>203,236</u></b>
<b>Net asset value</b>	<b>\$ <u>1,741,120,900</u></b>	<b>\$ <u>1,480,216,590</u></b>
Units Outstanding (Note 2)	1,741,120,900	1,480,216,590
Unit Value (Note 2)	\$ 1	\$ 1

**STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Net asset value, beginning of year	\$ 1,480,216,590	\$ 1,421,022,795
Value of units purchased by participants	6,123,148,064	6,284,553,085
Value of units sold by participants	<u>(5,862,243,754)</u>	<u>(6,225,359,290)</u>
<b>Net asset value, end of year</b>	<b>\$ <u>1,741,120,900</u></b>	<b>\$ <u>1,480,216,590</u></b>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Investment income (Note 2)	\$ 35,536,850	\$ 16,110,043
Security lending income	0	0
Security lending expense	0	0
Administrative expenses	(260,729)	(310,392)
Income due participants, beginning of year	<u>203,236</u>	<u>252,441</u>
<b>Income available for distribution</b>	<b>35,479,357</b>	<b>16,052,092</b>
<b>Distribution</b>	<b><u>34,950,528</u></b>	<b><u>15,848,856</u></b>
<b>Income due participants, end of year</b>	<b>\$ <u>528,829</u></b>	<b>\$ <u>203,236</u></b>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS  
SHORT TERM INVESTMENT POOL - NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2005 AND 2004**

**1. HISTORY AND ORGANIZATION**

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Short Term Investment Pool (STIP) was created by the Board to allow qualifying funds, per sections 17-6-201, 202 and 204, MCA, to participate in a diversified pool. Although state agencies with accounts that retain their interest earnings are legally required to invest in STIP, local governments may voluntarily participate in STIP.

The purpose of STIP is to obtain the highest possible return, yet maintain a highly liquid position whereby funds may be invested for relatively short periods, one day or more, depending upon the participant's anticipated use of the funds. The investments and the income from STIP are owned by the participants, as they purchase units, and are managed on their behalf by the Board.

Although STIP is not registered with the Securities and Exchange Commission (SEC) as an investment company, the Board has as policy that STIP will, and does, operate in a manner consistent with the SEC's rule 2a7 of the Investment Company Act of 1940. In meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Investments**

STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The STIP portfolio may include asset-backed securities, commercial paper, corporate and government securities, repurchase agreements, and variable-rate (floating-rate) instruments. These securities are purchased to provide shareholders with a diversified portfolio earning a competitive total rate of return.

Asset-backed securities represent debt securities collateralized by a pool of mortgage and non-mortgage assets such as trade and loan receivables, equipment leases, credit cards, etc. Commercial paper is unsecured short-term debt with maturities ranging from 1 to 270 days. Commercial paper issued at a discount, direct or by brokers, is backed by bank credit lines. Repurchase agreements (REPOs) represent an agreement between a seller and a buyer, usually of US government securities, whereby the seller agrees to repurchase the securities at an agreed upon price and stated time. Variable-rate (floating-rate) securities pay a variable rate of interest until maturity. The STIP portfolio's variable-rate securities float with LIBOR (London Interbank Offered Rate).

Investments held are reported at fair value as of June 30, based on market prices supplied to the Board by the Board's custodial bank. The difference between amortized cost and fair value is reflected as an unrealized gain or loss in the investments managed. The STIP investment portfolio consists of securities with a maximum maturity of 397 days or less with the exception of securities having rate reset dates. The portfolio is carried at amortized cost or book value.

**Participant Units**

The STIP unit value is fixed at \$1 for both participant buys and sells. A purchased unit earns income on the purchase date and ceases to earn income on the day before the unit is sold. Participants may buy or sell fractional shares. For fiscal years 2005 and 2004, income was distributed on the first calendar day of each month, with the exception of the June distribution. Income for June 2005 and June 2004 was distributed on the last calendar day of the month. Participants may automatically reinvest their income in additional units.

During fiscal years 2005 and 2004, the Board did not provide or obtain any legally binding guarantees to support the value of the participant units.

**Broker Receivable/Payable**

STIP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the STIP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.



## Other

Administrative expenses incurred by the Board are charged daily to STIP based on the Board's expenses applicable to STIP.

### **3. SECURITIES LENDING**

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2005 and 2004, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2005 and 2004 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2005 and 2004. Moreover, there were no losses during fiscal years 2005 and 2004 resulting from a default of the borrowers or State Street.

During fiscal years 2005 and 2004, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 35 and 49 days, respectively, as of June 30, 2005 and 2004. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2005 and June 30, 2004, there were no securities on loan.

### **4. INVESTMENT RISK DISCLOSURES**

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

#### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The STIP securities have credit risk as measured by major credit rating services. This risk is that the issuer of a STIP security may default in making timely principal and interest payments. The Board of Investment's policy requires that STIP securities have the highest investment grade rating in the short term category by at least one Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality per GASB Statement No. 40.

The short term credit ratings presented in the table below are provided by S&P's rating services. An A1+ rating is the highest short term rating by the S&P rating service. If a STIP security received a long term rating, such as AAA, this rating was converted to a short term rating. If an S&P rating is not available, a Moody's rating has been used.

#### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all STIP securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. According to the STIP



Investment Policy, “repurchase agreements require electronic delivery of U.S. Government Treasury collateral, priced at 102 percent market value, to the designated State of Montana Federal Reserve Bank account.”

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government’s investment in a single issuer. The STIP Investment Policy Statement does not specifically address concentration of credit risk. The policy does provide for “minimum three (3%) percent or \$15 million, whichever is higher, to be invested in Repurchase Agreements.” As of June 30, 2005, there were no single issuer investments that exceeded 5% of the STIP portfolio.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. According to GASB Statement No. 40, “interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool”.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

While variable-rate (floating-rate) securities have credit risk identical to similar fixed-rate securities, their interest rate risk is more sensitive to interest rate changes. However, their fair value may be less volatile than fixed-rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

STIP investments are categorized below to disclose credit rate risk as of June 30, 2005 Credit risk reflects the security quality rating, by investment security type, as of the June 30 report date. If a security investment type is unrated, the quality type is indicated by NR (not rated). Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated by the NRSRO.

#### Credit Quality Ratings as of June 30, 2005

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>
Commercial Paper	\$ 1,249,527,386	A1
Corporate Fixed	49,821,250	A1+
Corporate Variable-Rate	414,951,800	A1+
Municipal Variable-Rate	6,000,000	NR
Repurchase Agreement*	<u>22,000,000</u>	<u>A3</u>
Total Investments	\$ <u>1,742,300,436</u>	<u>A1+</u>
Securities Lending Collateral Investment Pool	\$ 0	NR

\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at a fair value of \$22 million by a \$17.1 million par, 6.375% coupon, U.S. government Treasury bond maturing August 15, 2027.

### Legal Risk

The Board is not aware of any legal risks regarding any STIP investments.

## 5. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

The trading system will serve the Board's internally managed portfolios and will be phased in as training is completed. Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Electronic trading for the Short Term Investment Pool will be next followed by the other fixed income portfolios managed by Board Staff.

## 6. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 7. YEAR END PORTFOLIO

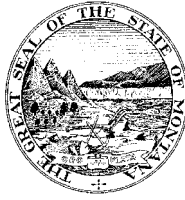
The June 30, 2005 STIP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>%</u>
AUTOBAHN FUNDING CO LLC	discount	09/23/05	17,500,000	17,359,125	17,360,000	1.00%
BEETHOVEN FUNDING CORP	discount	07/11/05	20,000,000	19,982,833	19,980,000	1.15%
BELMONT FUNDING LLC	discount	07/01/05	20,000,000	20,000,000	19,998,000	1.15%
BRITANNIA BUILDING SOCIETY	discount	08/31/05	20,000,000	19,890,878	19,885,400	1.14%
BRITANNIA BUILDING SOCIETY	discount	08/31/05	20,000,000	19,890,200	19,885,400	1.14%
BRYANT PARK FUNDING LLC	discount	08/08/05	20,000,000	19,932,656	19,927,800	1.14%
CAFCO LLC	discount	07/19/05	20,000,000	19,968,900	19,965,400	1.15%
CHECK POINT CHARLIE, INC	discount	08/09/05	20,000,000	19,930,233	19,926,000	1.14%
CHECK POINT CHARLIE, INC	discount	09/14/05	20,100,000	19,959,300	19,956,084	1.15%
CHECK POINT CHARLIE, INC	discount	09/15/05	20,000,000	19,858,133	19,855,000	1.14%
CLIPPER RECEIVABLES CORP	discount	07/20/05	20,000,000	19,967,278	19,963,600	1.15%
COBBLER FUNDING LTD	discount	07/28/05	20,000,000	19,953,350	19,949,200	1.14%
COBBLER FUNDING LTD	discount	09/28/05	20,000,000	19,828,922	19,830,600	1.14%
DAVIS SQUARE FUNDING III LTD	discount	09/06/05	20,000,000	19,874,561	19,935,200	1.14%
DNA FINANCE CORP	discount	07/12/05	20,000,000	19,980,811	19,872,000	1.14%
DNA FINANCE CORP	discount	08/04/05	20,000,000	19,938,989	19,978,200	1.15%
EIFFEL FUNDING	discount	09/19/05	20,000,000	19,850,222	19,847,400	1.14%
GOLDEN FISH LTD	discount	07/06/05	20,000,000	19,991,306	19,989,200	1.15%
GOLDEN FISH LTD	discount	08/05/05	20,000,000	19,937,389	19,933,400	1.14%
GRAMPIAN FUNDING LTD / LLC	discount	09/27/05	20,000,000	19,834,756	19,832,400	1.14%
GREYHAWK FUND CORP	discount	08/12/05	20,000,000	19,924,867	19,896,400	1.14%
GREYHAWK FUND CORP	discount	08/16/05	20,000,000	19,917,711	19,913,000	1.14%
GREYHAWK FUND CORP	discount	08/25/05	20,000,000	19,902,222	19,920,400	1.14%
HERTZ FLEET FUNDING LLC	discount	07/01/05	20,000,000	20,000,000	19,998,200	1.15%
HERTZ FLEET FUNDING LLC	discount	08/02/05	19,865,000	19,808,495	19,804,412	1.14%
IXIS CP CORP	discount	09/26/05	20,000,000	19,836,633	19,834,200	1.14%
KAISERPLATZ DELAWARE	discount	08/24/05	20,000,000	19,902,500	19,898,200	1.14%
LAKE CONSTANCE FUNDING	discount	08/18/05	20,000,000	19,914,667	19,909,400	1.14%
LEGACY CAPITAL CORP	discount	08/11/05	20,000,000	19,927,339	19,922,400	1.14%
LIBERTY HARBOUR	discount	07/13/05	20,000,000	19,979,267	19,976,400	1.15%
LIBERTY HARBOUR	discount	08/10/05	20,000,000	19,928,667	19,924,200	1.14%

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>%</u>
LOCKHART FUNDING LLC	discount	07/01/05	20,000,000	20,000,000	19,947,400	1.14%
LOCKHART FUNDING LLC	discount	07/29/05	20,000,000	19,951,311	19,998,200	1.15%
MANHATTAN ASSET FUND	discount	09/29/05	20,000,000	19,828,000	19,828,600	1.14%
MANHATTAN ASSET FUND	discount	09/30/05	20,000,000	19,825,583	19,826,800	1.14%
MAXIMILLIAN CAPITAL CORP	discount	07/15/05	20,000,000	19,975,889	19,972,800	1.15%
MAXIMILLIAN CAPITAL CORP	discount	08/15/05	20,000,000	19,919,500	19,915,000	1.14%
MICA FUNDING LLC	discount	07/18/05	20,000,000	19,970,722	19,967,400	1.15%
MILLSTONE FUNDING LTD	discount	08/03/05	20,000,000	19,941,333	19,937,200	1.14%
MONT BLANC CAPITAL CORP	discount	07/14/05	19,783,000	19,760,854	19,757,876	1.13%
NEPTUNE FUNDING CORP	discount	07/08/05	20,000,000	19,987,983	19,985,400	1.15%
NORTH SEA FUNDING	discount	07/27/05	20,000,000	19,954,933	19,951,000	1.15%
NORTH SEA FUNDING	discount	08/23/05	20,000,000	19,905,778	19,900,200	1.14%
PB FINANCE DEL INC	discount	07/25/05	20,000,000	19,958,400	19,954,600	1.15%
PERRY FUNDING CORP	discount	08/01/05	20,000,000	19,945,233	19,940,800	1.14%
PREFERRED RECEIVABLES FUNDING	discount	08/29/05	20,000,000	19,894,128	19,889,000	1.14%
PRIME ASSET VEHICLE	discount	09/20/05	20,000,000	19,848,350	19,845,600	1.14%
QUATRO PMX LTD/CORP	discount	07/05/05	20,000,000	19,993,156	19,991,000	1.15%
RHINELAND FUNDING	discount	09/13/05	20,000,000	19,861,044	19,858,800	1.14%
RHINELAND FUNDING	discount	09/16/05	20,000,000	19,854,556	19,853,200	1.14%
ROMULUS FUNDING CORP	discount	07/26/05	20,000,000	19,956,389	19,952,800	1.15%
SCALDIS CAPITAL LTD	discount	08/25/05	21,165,000	21,061,527	21,122,670	1.21%
SCALDIS CAPITAL LTD	discount	08/30/05	20,000,000	19,892,667	19,840,000	1.14%
ST GERMAIN HOLDINGS	discount	07/22/05	20,000,000	19,963,833	19,896,400	1.14%
ST GERMAIN HOLDINGS	discount	09/23/05	20,000,000	19,842,733	19,887,200	1.14%
STARBIRD FUNDING CORP	discount	07/28/05	20,000,000	19,953,200	19,947,400	1.14%
STARBIRD FUNDING CORP	discount	07/29/05	20,000,000	19,951,467	19,949,200	1.14%
SUNBELT FUNDING CORP	discount	07/07/05	20,000,000	19,989,700	19,987,200	1.15%
SYDNEY CAPITAL INC	discount	07/21/05	20,000,000	19,965,556	19,961,800	1.15%
SYDNEY CAPITAL INC	discount	08/19/05	19,868,000	19,780,923	19,770,647	1.13%
SYDNEY CAPITAL INC	discount	08/22/05	20,000,000	19,907,267	19,907,600	1.14%
THREE CROWNS FUNDING	discount	08/26/05	20,189,000	20,088,504	20,082,604	1.15%
WINDMILL FUNDING CORP	discount	08/17/05	16,105,000	16,037,717	16,033,494	0.92%
<b>COMMERCIAL PAPER</b>			<b>1,254,575,000</b>	<b>1,249,740,444</b>	<b>1,249,527,386</b>	<b>71.72%</b>
SIGMA FINANCE INC	3.735	04/21/06	25,000,000	24,998,872	24,926,250	1.43%
TOYOTA MOTOR CREDIT CORP	3.650	04/13/06	25,000,000	25,000,000	24,895,000	1.43%
<b>CORPORATE FIXED</b>			<b>50,000,000</b>	<b>49,998,872</b>	<b>49,821,250</b>	<b>2.86%</b>
GOLDMAN SACHS PROMISSORY NOTE	3.220	02/08/06	40,000,000	40,000,000	39,974,800	2.29%
HARRIER FINANCE FUNDING	3.200	07/15/05	50,000,000	50,000,000	49,998,500	2.87%
LIBERTY LIGHTHOUSE US CAP CO	3.110	04/05/06	25,000,000	24,997,523	24,998,000	1.43%
LIQUID FUNDING LTD	3.280	10/17/05	50,000,000	50,000,000	50,000,000	2.87%
PARKLAND USA L L C	3.240	04/19/06	25,000,000	25,000,000	24,997,000	1.43%
PARKLAND USA LLC	3.230	05/22/06	25,000,000	25,000,000	24,995,750	1.43%
PREMIER ASSET ENTITY LTD	3.180	09/15/05	50,000,000	50,000,000	49,998,500	2.87%
SEDNA FINANCE INC	3.279	02/27/06	25,000,000	25,000,000	24,998,000	1.43%
SIGMA FINANCE INC	2.970	03/10/06	25,000,000	24,998,679	24,997,500	1.43%
TANGO FINANCE CORP	3.175	03/13/06	25,000,000	25,000,000	24,997,250	1.43%
THETA CORP	3.175	03/13/06	25,000,000	25,000,000	24,999,000	1.43%
WHITE PINE FINANCE	3.090	07/11/05	50,000,000	50,000,000	49,997,500	2.87%
<b>CORPORATE VARIABLE-RATE (FLOATING RATE)</b>			<b>415,000,000</b>	<b>414,996,202</b>	<b>414,951,800</b>	<b>23.82%</b>
MT HIGHER ED STUDENT ASSOCIATION	3.610	01/15/06	6,000,000	6,000,000	6,000,000	0.34%
<b>MUNICIPAL VARIABLE-RATE (FLOATING RATE)</b>			<b>6,000,000</b>	<b>6,000,000</b>	<b>6,000,000</b>	<b>0.34%</b>
REPURCHASE AGREEMENT	2.700	07/01/05	22,000,000	22,000,000	22,000,000	1.26%
<b>REPURCHASE AGREEMENT</b>			<b>22,000,000</b>	<b>22,000,000</b>	<b>22,000,000</b>	<b>1.26%</b>
<b>STIP TOTAL</b>			<b>1,747,575,000</b>	<b>1,742,735,519</b>	<b>1,742,300,436</b>	<b>100.00%</b>

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Domestic Equity Pool, as of June 30, 2005, and 2004, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Domestic Equity Pool, as of June 30, 2005, and 2004, and its changes in net asset value and investment income and distribution for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA DOMESTIC EQUITY POOL FINANCIAL STATEMENTS  
STATEMENT OF NET ASSET VALUE JUNE 30, 2005 AND 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Cash	\$ 0	\$ 0
Security lending cash collateral (Notes 3 and 4)	28,995,031	20,641,660
Dividend receivable	1,472,227	2,047,731
Interest receivable	92,951	26,061
Investments managed at fair value (carrying value of \$2,609,202,578 in 2005 and \$2,479,060,702 in 2004)(Notes 2 and 4)	<u>3,011,913,931</u>	<u>2,902,284,868</u>
Total assets	\$ <u>3,042,474,140</u>	\$ <u>2,925,000,320</u>
<u>Liabilities</u>		
Income due participants	\$ 1,988,934	\$ 2,611,096
Security lending expense payable	88,165	21,517
Security lending obligations (Notes 3 and 4)	<u>28,995,031</u>	<u>20,641,660</u>
Total liabilities	<u>31,072,130</u>	<u>23,274,273</u>
Net asset value	\$ <u>3,011,402,010</u>	\$ <u>2,901,726,047</u>
Units Outstanding (Note2)	23,404,482	23,600,184
Unit Value (Note 2)	\$ 128.67	\$ 122.95

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004

Net asset value, beginning of year	\$ 2,901,726,047	\$ 2,577,332,014
Value of MDEP units purchased by participants (Note 2)	599,999	62,463,000
Value of MDEP units sold by participants (Note 2)	(13,396,698)	(86,459,939)
Changes in fair value of investments managed (Note 2)	<u>122,472,662</u>	<u>348,390,972</u>
Net asset value, end of year	\$ <u>3,011,402,010</u>	\$ <u>2,901,726,047</u>

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004

Investment income (Note 2)	\$ 39,004,072	\$ 33,950,029
Security lending income	560,697	356,505
Security lending expense	(531,967)	(264,065)
Administrative expenses (Note 2)	(2,460,957)	(1,657,067)
Income due participants, beginning of year	<u>2,611,096</u>	<u>2,041,555</u>
Income available for distribution	39,182,941	34,426,957
Distribution (Note 2)	<u>37,194,007</u>	<u>31,815,861</u>
Income due participants, end of year	\$ <u>1,988,934</u>	\$ <u>2,611,096</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA DOMESTIC EQUITY - NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005 AND 2004

**1. HISTORY AND ORGANIZATION**

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Montana Common Stock Pool (MTCP) was created by the Board to allow retirement and endowment funds, per section 17-6-201, MCA, the opportunity to participate in the equity market via a diversified pool. MTCP was created as of July 1, 1980, by the transfer of all common stock owned by the Public Employees' Retirement System, Teachers' Retirement System, and other funds into MTCP.

In March 1996, the Board approved the Investment Policy Statement to reflect the name change from the Montana Common Stock Pool to the Montana Stock Pool. The Montana Stock Pool is referred to as "Montcomp" or MTCP. This policy statement provided for the investment in common or preferred stock. The Investment Policy Statement has been subsequently revised and approved to allow investment in the following security types:

September 1996	Securities convertible into common or preferred stocks
June 2000	Equity derivatives
January 2004	American Depositary Receipts (ADR's)

The Board authorized creation of the Montana Domestic Equity Pool (MDEP) in April 2003. The pool combines the domestic equity investments of the Montana Stock Pool (MTCP), Barclays Global Investors (BGI) and Dimensional Fund Advisors (DFA). Effective May 1, 2003, the Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds transferred all their BGI S&P 500 Equity Index Fund A and the DFA Small Cap Subtrust investments totaling \$740 million, at cost, from the All Other Funds portfolio to the new pool. The pension and endowment funds also exchanged their investment in the Montana Stock Pool (MTCP) for units in the new Montana Domestic Equity Pool (MDEP).

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Investments**

MDEP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The MDEP portfolio may include common stock, equity index, preferred stock, convertible equity securities, American Depositary Receipts (ADR's) and equity derivatives. Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters as well as receive dividends on their holdings. Equity index investments are investments in selected mutual funds whose equity portfolios match a broad based index or composite. Preferred stock, as a class of stock, pays dividends at a specified rate and has preference in the payment of dividends and liquidation of assets. Preferred stock holders, ordinarily, do not have voting rights. Convertible securities are securities carrying the right to exchange, or "convert" the instrument for other securities of the issuer or of another issuer. This definition most often applies to preferred stocks or corporate bonds carrying the right to exchange for a fixed number of shares of the issuer's common stock. ADR's are receipts issued by a US depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. Equity derivatives "derive" their value from other equity instruments such as futures and options.

In June 2000, the Board approved the securitization of MTCP cash by investing in an equity derivative, the State Street Stock Performance Index Futures Fund (SPIFF). Portfolio cash is swept daily into SPIFF maintaining 100% equity exposure through holdings of stock index futures.

As a liquidity option, the Board approved investment by MTCP in Board's Short Term Investment Pool (STIP) in October 2004. STIP, as an external investment pool, commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

The MDEP, as an internal investment pool, invested its excess cash, on pool creation, in STIP. In July 2003, the STIP account was closed and a SPIFF account was opened to securitize MDEP cash by investing in an equity derivative.

In January 2003, the Board approved a staff recommendation to hire Dimensional Fund Advisors (DFA), as an external manager, to invest in domestic small market capitalization (small cap) companies. Market capitalization refers to the value of a corporation as determined by the market price of its issued and outstanding common stock. DFA's Small Cap Subtrust targets those companies whose market capitalization comprises the smallest 8 percent of the total market universe. The total market universe is defined as the aggregate capitalization of the NYSE, AMEX and NASDAQ firms.

Based on Board approval, staff made an initial investment of \$10 million in the Barclays Global Investors (BGI) S&P 400 Mid Cap Equity Index fund in December 2004. Investments in this fund totaled \$100 million on June 30, 2005.

As directed by the Board to rebalance the MDEP portfolio, staff exchanged 893,504 MTCP units at a gain of \$207,282,346 for shares valued at \$338,356,609 in the BGI US Equity Restructure Account in February 2005. The Restructure Account was closed and shares were transferred to the BGI S&P 500 Equity Index Account Fund A at a loss of \$2,822,974. This rebalancing transaction represented the transfer of over 8.4 million shares in 114 positions held in MTCP. Subsequent sales of MTCP units for \$160 million generated MDEP realized gains of \$97.3 million. MTCP sale proceeds were invested in the BGI S&P 500 Equity Index Account Fund A.

Other MDEP rebalancing actions in fiscal year 2005 included the \$110 million sale of DFA Small Cap Subtrust shares. These sales resulted in MDEP realized gains of \$27.2 million.

Investments are presented in the statement of Net Asset Value at fair value. Equity investments, on valuation date, are stated at the closing price of the security's primary exchange. Carrying value, parenthetically disclosed, represents the equity security purchase price plus a fixed commission where applicable.

#### Participant Units

The Public Employees' Retirement System and the Teachers' Retirement System transferred all stock owned into MTCP at the start-up date and were issued units according to the fair value of their contribution, retaining their original total cost basis. The initial unit value as of July 1, 1980, was \$1,000. Unit values thereafter and until March 31, 2000 were calculated weekly and at the close of the last business day of the month, based on the fair value of MTCP equity holdings and other assets. Effective April 1, 2000, the unit values are calculated daily. Daily unit value calculations were discontinued as of January 1, 2003. Since January 2003, MTCP unit values are calculated weekly and at the close of the last business day of the month. Depending on stock market conditions and the investment officer's decision, MDEP participants may then buy or sell units on the first calendar day of each month based on the month end values.

On July 1, 1994, the initial unit value changed from \$1,000 to \$100. This change was required for the Board's new accounting system. On August 17, 2000, shareholders, on record, received one MTCP share for each MTCP share held as the result of a 2:1 split. The unit value on August 31, 2000, prior to the split, was \$1,014 while the unit value, after the split, was \$507.

On May 1, 2003, the pension funds transferred all the Barclays Global Investors (BGI) S&P 500 Equity Index Fund A and the Dimensional Fund Advisors (DFA) Small Cap Subtrust investments, at cost, to the MDEP. On the same date, the pension and endowment funds transferred their MTCP investments, at cost, to the MDEP. The pension and endowment funds were issued units according to the fair value of each participant's portfolio. The initial MDEP unit value on May 1, 2003 was \$100. On conversion date, MTCP participants exchanged approximately 5.8 million MTCP units, valued at \$302 per unit, for 24.1 million MDEP units, issued at \$100 per unit.

As reported in the Statement of Changes in Net Asset Value, the value of MDEP units purchased and sold by participants in fiscal years 2005 and 2004 are the result of asset allocation decisions and pool participant's cash needs. The fiscal year 2005 Change in Fair Value of Investments Managed of \$122.5 million reflects equity market depreciation of \$(196.1) million, participant gain distribution of \$(12.7) million and net pool realized gains of \$331.3 million. The fiscal year 2004 Change in Fair Value of Investments Managed of \$348.4 million represents equity market appreciation of \$314.8 million, participant gain distribution of \$(67.0) million and net pool realized gains of \$100.6 million.

### Broker Receivable/Payable

MDEP security transactions are recorded as of trade date rather than settlement date. Because of this generally accepted practice, the MDEP portfolio at June 30 may include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

### Other

Investment income reported in the Statement of Investment Income and Distribution includes dividend accruals, tax reclaim accruals, SPIFF gain/losses and miscellaneous income. MDEP dividends are recorded on the ex-dividend date.

The MDEP Income Available for Distribution is distributed as of the first calendar day of each month. Administrative expenses incurred by the Board are charged daily to MDEP based on the Board's expenses applicable to MDEP. For fiscal years 2005 and 2004, these expenses include \$1,313,197 and \$1,038,000, respectively, for the Board and the custodial bank contract and \$1,147,760 and \$619,067, respectively, in external manager fees.

## 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2005 and 2004, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received US dollar currency cash, US government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2005 and 2004 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2005 and 2004. Moreover, there were no losses during fiscal years 2005 and 2004 resulting from a default of the borrowers or State Street.

During fiscal years 2005 and 2004, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 35 and 49 days, respectively, as of June 30, 2005 and 2004. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2005, the carrying and fair values of the underlying securities on loan of the MTCP for the MDEP were \$28,062,757 and \$28,402,082 respectively. The collateral provided for the securities on loan totaled \$28,995,031 in cash.

As of June 30, 2004, the carrying and fair values of the underlying securities on loan of the MTCP for the MDEP were \$18,798,876 and \$20,254,272 respectively. The collateral provided for the securities on loan totaled \$20,641,660 in cash.

## 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all the MDEP securities were registered in the nominee name for the



Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The BGI S&P 500 Equity Index Fund A, S&P 400 MidCap Equity Index Fund and the DFA Small Cap Subtrust are registered in the name of the Montana Board of Investments.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments in pooled investments, such as the BGI Equity Index and DFA Small Cap Subtrust investments, are excluded from this requirement. As of June 30, 2005 and 2004, there were no single issuer investments that exceeded 5% of the MDEP portfolio.

The MDEP investments are disclosed by investment type in the following table and in Note 8 Year End Portfolio for 2005.

<u>Security Investment Type</u>	<u>2005</u>		<u>2004</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Montana Stock Pool (MTCP)	\$ 1,264,857,181	\$ 1,501,726,262	\$ 1,635,260,778	\$ 1,941,940,158
BGI S&P 500 Equity Index Fund A	1,039,695,685	1,132,427,186	544,162,050	596,835,124
DFA Small Cap Subtrust	177,282,131	243,808,328	260,000,000	323,104,286
BGI S&P 400 MidCap Equity Index Fund	100,000,000	106,616,769	0	0
Short Term Investment Pool (STIP)	0	0	0	0
Stock Performance Index Futures Fund (SPIFF)	<u>27,367,581</u>	<u>27,335,386</u>	<u>39,637,874</u>	<u>40,405,300</u>
Total Investment	\$ <u>2,609,202,578</u>	\$ <u>3,011,913,931</u>	\$ <u>2,479,060,702</u>	\$ <u>2,902,284,868</u>
Securities Lending Collateral Investment Pool	\$ <u>28,995,031</u>	\$ <u>28,995,031</u>	\$ <u>20,641,660</u>	\$ <u>20,641,660</u>

### 5. OWENS-CORNING COMPLAINT

On October 11, 2002, the Board received a summons and complaint regarding the bankruptcy of Owens-Corning. The company seeks a determination that the dividend payments paid from October 1996 through July 2000 represent "fraudulent transfers under Chapter 11 Bankruptcy provisions and applicable state law, and are, therefore, voidable". The complaint states the Montana Board of Investments was the "recipient of dividends in the amount of \$357,099 for the relevant period". The Board has prepared a response to the complaint.

### 6. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

The trading system will serve the Board's internally managed portfolios and will be phased in as training is completed. Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Electronic trading for the Short Term Investment Pool will be next followed by the other fixed income portfolios managed by Board Staff.

### 7. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written

documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 8. YEAREND PORTFOLIO

The June 30, 2005 MDEP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

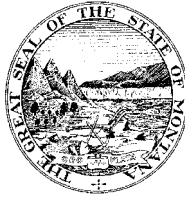
<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
GENERAL ELECTRIC CO	2,138,200	46,061,381	74,088,630	2.46%
EXXON MOBIL CORP	1,136,612	31,681,611	65,321,092	2.17%
CITIGROUP INC	1,063,366	18,155,198	49,159,410	1.63%
JOHNSON + JOHNSON	667,300	12,553,948	43,374,500	1.44%
MICROSOFT CORP	1,680,000	59,471,835	41,731,200	1.39%
PFIZER INC	1,475,960	57,161,613	40,706,977	1.35%
BANK AMERICA CORP	809,100	32,104,371	36,903,051	1.23%
INTEL CORP	1,281,500	10,691,206	33,395,890	1.11%
CHEVRON CORP	594,500	21,474,653	33,244,440	1.10%
WAL MART STORES INC	626,000	31,211,664	30,173,200	1.00%
J P MORGAN CHASE + CO	827,000	28,915,619	29,209,640	0.97%
AMERICAN INTERNATIONAL GROUP INC	490,000	25,230,450	28,469,000	0.95%
WELLS FARGO + CO	442,400	7,571,043	27,242,992	0.90%
ALTRIA GROUP INC	398,400	16,760,490	25,760,544	0.86%
ABBOTT LABS	460,000	4,018,014	22,544,600	0.75%
CISCO SYSTEMS INC	1,100,000	15,899,136	21,021,000	0.70%
INTERNATIONAL BUSINESS MACHINES	278,000	12,611,647	20,627,600	0.68%
UNITED TECHNOLOGIES CORP	400,000	6,773,503	20,540,000	0.68%
TYCO INTERNATIONAL LTD	697,000	13,585,473	20,352,400	0.68%
AMGEN INC	331,300	17,614,753	20,030,398	0.67%
PEPSICO INC	357,000	17,242,558	19,253,010	0.64%
CONOCOPHILLIPS	329,760	11,655,067	18,957,902	0.63%
BANK NEW YORK INC	639,000	23,681,520	18,390,420	0.61%
MORGAN STANLEY	346,000	17,533,214	18,154,620	0.60%
MERRILL LYNCH + CO INC	323,700	18,415,304	17,806,737	0.59%
TEXAS INSTRUMENTS INC	603,500	23,524,853	16,940,245	0.56%
DELL INC	412,000	15,044,915	16,278,120	0.54%
UNITED PARCEL SERVICE INC	229,100	15,097,673	15,844,556	0.53%
3M CO	215,000	13,373,753	15,544,500	0.52%
LILLY ELI + CO	279,000	16,557,074	15,543,090	0.52%
MEDTRONIC INC	300,000	13,882,683	15,537,000	0.52%
TARGET CORP	283,000	11,597,309	15,398,030	0.51%
GOLDMAN SACHS GROUP INC	149,400	13,226,928	15,241,788	0.51%
ORACLE CORP	1,132,500	16,192,081	14,949,000	0.50%
SCHLUMBERGER LTD	194,100	11,107,641	14,739,954	0.49%
DISNEY WALT CO	580,600	17,068,193	14,619,508	0.49%
FEDERAL NATIONAL MORTGAGE ASSN	250,000	15,869,549	14,600,000	0.48%
WYETH	326,200	18,356,447	14,515,900	0.48%
PROCTER + GAMBLE CO	265,600	11,133,515	14,010,400	0.47%
ALLTEL CORP	220,000	13,396,679	13,701,600	0.45%
QUALCOMM INC	415,000	13,915,262	13,699,150	0.45%
UNITEDHEALTH GROUP INC	249,000	7,900,074	12,982,860	0.43%

HEWLETT PACKARD CO	548,200	11,165,362	12,888,182	0.43%
MELLON FINANCIAL CORP	445,200	18,697,097	12,772,788	0.42%
DU PONT E I DE NEMOURS + CO	278,900	10,860,531	11,995,489	0.40%
COMCAST CORP	388,000	10,358,359	11,911,600	0.40%
FEDERAL HOME LOAN MTG CORP	182,600	9,802,220	11,910,998	0.40%
DOW CHEM CO	257,300	12,213,022	11,457,569	0.38%
HALLIBURTON CO	233,900	6,633,990	11,185,098	0.37%
TIME WARNER INC	649,100	20,422,348	10,846,461	0.36%
GILLETTE CO	209,000	10,659,328	10,581,670	0.35%
BIOMET INC	300,000	12,776,010	10,392,000	0.35%
APPLE COMPUTER	280,000	10,483,363	10,306,800	0.34%
BEST BUY CO INC	150,000	5,418,984	10,282,500	0.34%
EMC CORP	700,000	11,517,372	9,597,000	0.32%
MOTOROLA INC	522,900	8,250,696	9,548,154	0.32%
TEVA PHARMACEUTICAL INDS LTD	300,000	8,504,312	9,342,000	0.31%
TJX COS INC	378,900	8,841,371	9,226,215	0.31%
APACHE CORP	140,000	8,203,124	9,044,000	0.30%
HOME DEPOT INC	230,000	8,328,193	8,947,000	0.30%
TRANSOCEAN INC	160,000	7,573,873	8,635,200	0.29%
HONEYWELL INTERNATIONAL INC	230,000	7,303,670	8,424,900	0.28%
SYSCO CORP	231,100	7,662,563	8,363,509	0.28%
SYMANTEC CORP	383,000	9,696,839	8,326,420	0.28%
VERIZON COMMUNICATIONS	240,000	7,089,277	8,292,000	0.28%
EBAY INC	250,000	9,956,929	8,252,500	0.27%
WACHOVIA CORP	166,000	6,065,806	8,233,600	0.27%
AVON PRODUCTS INC	216,000	8,712,723	8,175,600	0.27%
SIEBEL SYSTEMS INC	850,000	7,882,405	7,565,000	0.25%
FIRST DATA CORP	187,600	6,801,873	7,530,264	0.25%
AIR PRODUCTS + CHEMICALS INC	124,500	6,136,682	7,507,350	0.25%
CINTAS CORP	190,000	7,744,240	7,334,000	0.24%
STRYKER CORP	154,000	7,174,324	7,324,240	0.24%
YAHOO INC	207,500	6,276,730	7,189,875	0.24%
ACCENTURE LTD	316,000	8,151,976	7,163,720	0.24%
OMNICOM GROUP	89,600	5,934,114	7,155,456	0.24%
VIACOM INC	218,000	8,739,655	6,980,360	0.23%
CAREMARK RX INC	152,000	4,975,027	6,767,040	0.22%
GUIDANT CORP	100,000	6,345,140	6,730,000	0.22%
BOSTON SCIENTIFIC CORP	249,000	7,697,497	6,723,000	0.22%
ZIMMER HOLDINGS INC	85,000	6,086,391	6,474,450	0.21%
EMERSON ELECTRIC CO	100,000	3,587,647	6,263,000	0.21%
FISHER SCIENTIFIC INTL INC	93,100	5,308,213	6,042,190	0.20%
MBNA CORP	230,000	4,296,939	6,016,800	0.20%
WALGREEN CO	130,000	3,863,561	5,978,700	0.20%
US BANCORP	202,000	5,714,725	5,898,400	0.20%
BED BATH + BEYOND INC	140,000	5,419,756	5,849,200	0.19%
ANADARKO PETE CORP	70,000	5,272,113	5,750,500	0.19%
GENENTECH INC	70,000	5,599,601	5,619,600	0.19%
AMERICAN EXPRESS CO	100,000	1,643,961	5,323,000	0.18%
COLGATE PALMOLIVE CO	100,000	4,992,010	4,991,000	0.17%
NEWS CORP	302,900	5,165,395	4,900,922	0.16%
PAYCHEX INC	150,000	5,311,486	4,881,000	0.16%
LEXMARK INTERNATIONAL INC	74,500	4,563,825	4,829,835	0.16%
FORTUNE BRANDS INC	53,900	2,339,925	4,786,320	0.16%
MCCORMICK + CO INC	135,000	4,737,133	4,411,800	0.15%
CITRIX SYS INC	200,000	4,496,100	4,332,000	0.14%
WASHINGTON MUTUAL INC	103,700	4,342,012	4,219,553	0.14%
COCA COLA CO	100,000	5,122,197	4,175,000	0.14%

FLEXTRONICS INTERNATIONAL LTD	310,000	4,918,866	4,095,100	0.14%
BRISTOL MYERS SQUIBB CO	158,000	6,482,036	3,946,840	0.13%
APPLIED MATERIALS INC	238,000	3,569,392	3,850,840	0.13%
VISHAY INTERTECHNOLOGY INC	310,000	5,130,115	3,679,700	0.12%
XILINX INC	140,000	4,407,456	3,570,000	0.12%
SAP AKTIENGESELLSCHAFT	80,000	2,993,312	3,464,000	0.12%
ADOBE SYSTEMS INC	100,000	3,116,090	2,862,000	0.10%
<b>MONTANA STOCK POOL TOTAL</b>	<b>39,680,498</b>	<b>1,264,857,181</b>	<b>1,501,726,262</b>	<b>49.86%</b>
BGI S&P 500 EQUITY INDEX FUND A	3,488,920	1,039,695,684	1,132,427,185	37.60%
BGI CASH	1	1	1	0.00%
<b>BGI EQUITY INDEX FUND</b>	<b>3,488,921</b>	<b>1,039,695,685</b>	<b>1,132,427,186</b>	<b>37.60%</b>
DIMENSIONAL FUND ADVISORS INC	263,374	177,282,131	243,808,328	8.09%
<b>DFA SMALL CAP SUBTRUST</b>	<b>263,374</b>	<b>177,282,131</b>	<b>243,808,328</b>	<b>8.09%</b>
BGI S&P 400 MIDCAP EQUITY INDEX FUND	6,289,916	100,000,000	106,616,769	3.54%
<b>BGI S&amp;P 400 MIDCAP EQUITY INDEX FUND</b>	<b>6,289,916</b>	<b>100,000,000</b>	<b>106,616,769</b>	<b>3.54%</b>
STATE STREET SPIFF	127,710	19,849,144	19,859,236	0.66%
STATE STREET SPIFF	48,077	7,518,437	7,476,150	0.25%
<b>TOTAL EQUITY FUTURES</b>	<b>175,787</b>	<b>27,367,581</b>	<b>27,335,386</b>	<b>0.91%</b>
<b>MDEP TOTAL</b>	<b><u>49,898,496</u></b>	<b><u>2,609,202,578</u></b>	<b><u>3,011,913,931</u></b>	<b><u>100.00%</u></b>

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana International Equity Pool, as of June 30, 2005, and 2004, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana International Equity Pool, as of June 30, 2005, and 2004, and its changes in net asset value and investment income and distribution for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

**STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA INTERNATIONAL EQUITY POOL FINANCIAL STATEMENTS**

**STATEMENT OF NET ASSET VALUE JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b><u>Assets</u></b>		
Cash at fair value (carrying value of \$1,996,217 in 2005 and \$1,803,332 in 2004) (Notes 2, 4 and 7)	\$ 1,968,498	\$ 1,791,399
Security lending cash collateral (Notes 3 and 4)	34,537,173	43,804,312
Broker receivable for securities sold but not settled (Note 2)	735,494	6,267,489
Dividend and interest receivable	1,419,646	1,057,520
Investments managed at fair value (carrying value of \$840,131,984 in 2005 and \$786,482,403 in 2004) (Notes 2 and 4)	<u>993,518,620</u>	<u>853,937,359</u>
<b>Total assets</b>	<b>\$ <u>1,032,179,431</u></b>	<b>\$ <u>906,858,079</u></b>
<b><u>Liabilities</u></b>		
Income due participants	\$ 1,459,877	\$ 926,817
Broker payable for securities purchased but not settled (Note 2)	837,394	3,743,798
Security lending obligations (Note 3)	34,537,173	43,804,312
Security lending expense payable	113,089	37,056
Unrealized foreign exchange market gain (loss) (Note 7)	(1,670,430)	17,403
Administrative fee payable	<u>445,565</u>	<u>413,882</u>
<b>Total liabilities</b>	<b><u>35,722,668</u></b>	<b><u>48,943,268</u></b>
<b>Net asset value</b>	<b>\$ <u>996,456,763</u></b>	<b>\$ <u>857,914,811</u></b>
Units Outstanding (Note 2)	8,192,033	7,966,121
Unit Value (Note 2)	\$ 121.64	\$ 107.70

**STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Net asset value, beginning of year	\$ 857,914,811	\$ 446,667,840
Value of units purchased by participants (Note 2)	25,000,000	253,000,000
Value of units sold by participants	0	0
Changes in current value of investments managed	<u>113,541,952</u>	<u>158,246,971</u>
<b>Net asset value, end of year</b>	<b>\$ <u>996,456,763</u></b>	<b>\$ <u>857,914,811</u></b>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Investment income (Note 2)	\$ 11,001,773	\$ 9,158,659
Security lending income	1,317,472	716,276
Security lending expense	(1,106,889)	(447,343)
Administrative expenses (Note 2)	(2,641,330)	(2,280,171)
Income due participants, beginning of year	<u>926,817</u>	<u>771,639</u>
<b>Income available for distribution</b>	<b>9,497,843</b>	<b>7,919,060</b>
<b>Distribution (Note 2)</b>	<b><u>8,037,966</u></b>	<b><u>6,992,243</u></b>
<b>Income due participants, end of year</b>	<b>\$ <u>1,459,877</u></b>	<b>\$ <u>926,817</u></b>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA INTERNATIONAL EQUITY POOL**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 and 2004**

**1. HISTORY AND ORGANIZATION**

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Montana International Equity Pool (MTIP) was created by the Board to allow qualifying funds, per section 17-6-201, MCA, the opportunity to participate in the international equity market via a diversified pool. MTIP, approved by the Board in June 1996, consists of one pool investing in one or more separate funds. On January 3, 1997, the MTIP was funded by the Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds. Currently, the MTIP has investments with five externally managed funds, Pyrford International, Schroder Investment Management NA, Nomura Asset Management U.S.A. Inc., Barclays Global Investors and Dimensional Fund Advisors, Inc. (DFA).

On July 1, 2003, the Board funded MTIP with a \$35 million purchase in the State Street Stock Performance Index Futures Fund (SPIFF). SPIFF shares were subsequently sold to fund \$25 million to the BGI MSCI Europe Index Fund on July 3, 2003.

In August 2003, the Board invested \$15 million in the BGI All Country Pacific Index Strategy Fund.

On October 30, 2003, the Board retained Schroder Investment Management NA, hired Nomura Asset Management U.S.A. Inc. and terminated SG Yamaichi Asset Management, Co. as active managers for the Board's Pacific Basin equity mandate. Schroder Investment Management NA was originally selected by the Board in October 1996.

SG Yamaichi Asset Management, Co. ceased equity trading in the Pacific Basin on October 31, 2003. The MTIP investment in SG Yamaichi Asset Management, Co. of \$105 million was transferred to Nomura Asset Management U.S.A. Inc. Upon transition, Nomura Asset Management U.S.A. Inc. began equity trading in the Pacific Basin on December 1, 2003.

In fiscal year 2004, the Board funded \$15 million to BOI Internal International, \$170 million to the Barclays Global Investors (BGI) MSCI Europe Index Fund, \$40 million to the BGI All Country Pacific Index Strategy Fund and \$28 million to the State Street SPIFF account.

The internally managed fund, BOI Internal International, was closed in January 2004 and its assets sold and restructured by Barclays Global Investors for an investment of \$190.4 million in the BGI MSCI Europe Index Fund. The sale and restructure of the BOI Internal International fund generated a gain of \$25.7 million.

On October 21, 2004, the Board authorized the investment in the Dimensional Fund Advisors, Inc. (DFA) International Small Company Portfolio. In fiscal year 2005, the Board funded \$75 million to DFA International Small Company Portfolio, \$29.5 million to the Barclays Global Investors (BGI) MSCI Europe Index Fund and withdrew \$29.5 million from the State Street SPIFF account. In February and June 2005, the Board requested the sale of \$10 million and \$15 million respectively of BGI MSCI Europe Index Fund resulting in a combined gain of \$4.1 million. In March 2005, the Board sold \$25 million in units held by Schroders Investment Management NA and recorded a gain of \$5.6 million.

Schroder Investment Management NA, Nomura Asset Management U.S.A. Inc. from December 2003, SG Yamaichi Asset Management Co. through October 2003, and the BGI All Country Pacific Index Strategy Fund are authorized to invest in 12 Pacific Basin countries. These countries are listed as follows:

**Pacific Basin Countries**

Australia	Indonesia	Malaysia	Singapore
China	Japan	New Zealand	Taiwan
Hong Kong	Korea	Philippines	Thailand

As approved by the Board, the BOI Internal International fund, Pyrford International and the BGI MSCI Europe Index Fund may invest in 16 European countries. These countries are listed as follows:

### European Countries

Austria	France	Italy	Spain
Belgium	Germany	Netherlands	Sweden
Denmark	Greece	Norway	Switzerland
Finland	Ireland	Portugal	United Kingdom

The DFA International Small Company Portfolio invests in the European countries detailed above and the Pacific Basin countries of Australia, Hong Kong, Japan, New Zealand and Singapore.

In March 2003, the Board voted to liquidate all BOI Internal International holdings in France. On October 30, 2003, the Board voted to add France to the list of approved countries for the BOI Internal International portfolio.

In December 2003, the Board voted to retain Pyrford International, as an external investment manager for Europe. Pyrford International was originally selected by the Board in August 1998.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Investments

MTIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The MTIP portfolio includes equity investments in six funds - BOI Internal International through January 2004, Pyrford International, Schroder Investment Management NA, Nomura Asset Management U.S.A, Inc. from December 2003, SG Yamaichi Asset Management Co. through October 2003, the BGI MSCI Europe Index Fund, the BGI All Country Pacific Index Strategy Fund and DFA International Small Company Portfolio. The six funds may invest in securities of foreign-based corporations listed on legal and recognized foreign exchanges as well as domestic exchanges. Security types may include ordinary common shares, preferred shares, convertible securities, American Depositary Receipts (ADR's), Global Depositary Receipts (GDR's), and other global securities, as appropriate.

Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters as well as receive dividends on their holdings. Preferred stock pays a stipulated dividend and has a claim prior to that of common stock upon the earnings of a corporation. Convertible securities are securities carrying the right to exchange, or "convert" the instrument for other securities of the issuer or of another issuer. ADR's are receipts issued by a US depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. GDR's are receipts issued by non-US bank depositaries, which represent shares of a foreign stock or bonds.

### Broker Receivable/Payable

MTIP security transactions are recorded as of the trade date rather than settlement date. Because of this generally accepted practice, the MTIP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

### Valuation and Foreign Currency

Investments are presented in the statement of Net Asset Value at current US dollar value. The MTIP's fair value is derived from the Net Asset Value per Share, as separately calculated, for four funds - BOI Internal International through January 2004, Pyrford International, Schroder Investment Management NA, Nomura Asset Management U.S.A, Inc. from December 2003, and SG Yamaichi Asset Management Co. through October 2003. Each fund's Net Asset Value per Share represents the per unit ownership of the fund's Net Assets. The Net Assets are the excess of the valued securities, cash, receivables and other assets over the fund's liabilities. Each fund's Net Assets are reported at current US dollar value after conversion, by the custodial bank, State Street Bank and Trust, from the foreign currency amounts. The MTIP's fair value also includes the per share fair value of the BGI MSCI Europe Index Fund, the BGI All Country Pacific Index Strategy Fund, DFA International Small Company Portfolio and the State Street Bank SPIFF account.



State Street Bank, as custodian, is responsible for reporting the foreign currency transactions in both the local and base or functional (US dollar) currency. The four funds' cash, receivables, fair value of investment securities, other assets and liabilities are translated into US dollars at the Interactive Data Control (IDC) 11:00 a.m. Eastern Standard Time (EST) exchange rate as of the balance sheet date. Purchases and sales of investment securities, income and expenses are converted into US dollars using the Reuters noon EST exchange rate on the transaction date.

Currency exposures may be hedged, partially or fully, at the discretion of the manager to preserve the US dollar value of investments made. Currency speculation, such as over-hedging, reverse hedging or other trading activity not specifically aimed at preserving the US dollar value of investments, is not authorized.

Fair values for the funds holding the publicly traded securities are determined by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank, their primary pricing service, IDC, Barclays Global Investors and Dimensional Fund Advisors. Equity investments, traded on a national security exchange, are stated at the last reported sales price on valuation day, while equity securities traded in the over-the-counter market are stated at the last quoted bid price.

#### Participant Units

The Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds sold units in the Short Term Investment Pool at the start up date and were issued units in MTIP at an initial unit value of \$100. Unit values thereafter are calculated weekly and once a month at the close of the last business day of the month, based upon the fair value of the MTIP equity holdings, other assets and liabilities. Based on the investment officers' decision, participants may then buy or sell units on the first business day of each month. All participant buys or sells occur after distribution of accumulated income.

#### Investment Income and Distribution

Investment Income represents the monthly income distributions to the MTIP from the investment manager funds. The funds' income distributions include dividends accrued as of the ex-dividend date, interest, tax refunds and securities lending income, and related income currency gains/losses. Income currency gains/losses result from the difference between the amount of dividend, interest and foreign withholding taxes accrued for the fund in US dollars and the amount received or paid in equivalent US dollars.

Realized gains/losses from the sale of securities and related foreign exchange transactions are retained by each fund. Realized foreign exchange gains/losses arise from sales and maturities of portfolio securities, sales of foreign currencies, and currency gains/losses realized between the trade and settlement dates.

The fiscal year 2005 administrative expense of \$2,641,330 represents \$2,126,429 in quarterly fees accrued and paid to the external managers per their contracts and \$514,901 in monthly charges accrued and paid to the Board of Investments.

The fiscal year 2004 administrative expense of \$2,280,171 represents \$1,762,323 in quarterly fees accrued and paid to the external managers per their contracts and \$517,848 in monthly charges accrued and paid to the Board of Investments.

As described above, the Board of Investments fee includes costs for the custodial bank contract. Administrative expenses incurred by the Board are charged daily to MTIP based on the Board's expenses applicable to MTIP.

The MTIP Income Available for Distribution is distributed at least monthly to the retirement fund participants, net of external manager fees and administrative expenses, on the first business day of the following month.

### 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 105 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2005 and 2004, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received US dollar and foreign currency cash, US government securities, sovereign debt of foreign countries, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2005 and 2004 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2005 and 2004. Moreover, there were no losses during fiscal years 2005 and 2004 resulting from a default of the borrowers or State Street.

During fiscal years 2005 and 2004, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 35 and 49 days, respectively as of June 30, 2005 and 2004. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

The carrying amount and fair value of the underlying securities on loan for MTIP are detailed, by external investment manager, in the following table:

Carrying Amount and Fair Value of Securities on Loan

<u>External Investment Manager</u>	2005		2004	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Schroder Investment Mgmt.	\$ 6,217,820	\$ 7,804,614	\$ 13,211,062	\$ 15,558,175
Pyford International	8,367,610	11,720,776	19,179,273	25,316,583
Nomura Asset Management U.S.A., Inc	<u>11,360,634</u>	<u>14,147,953</u>	<u>717,352</u>	<u>872,784</u>
Total Investments on Loan	\$ <u>25,946,064</u>	\$ <u>33,673,344</u>	\$ <u>33,107,687</u>	\$ <u>41,747,542</u>
Securities Lending Collateral Investment Pool	\$ <u>34,537,173</u>	\$ <u>34,537,173</u>	\$ <u>43,804,312</u>	\$ <u>43,804,312</u>

As of June 30, 2005, the collateral provided for the securities on loan totaled \$34,537,173 in cash and \$779,936 in securities collateral. As of June 30, 2004, the collateral provided for the securities on loan totaled \$43,804,312 in cash collateral.

### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The financial statement disclosures for the year ended June 30, 2004 have been restated to compare with the financial statement disclosures for the year ended June 30, 2005. The investment risk disclosures are described in the following paragraphs.

#### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all the MTIP securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank,

State Street Bank. The BGI MSCI Europe and Pacific Index and the DFA Small Company Portfolio are registered in the name of the Montana Board of Investments.

### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The U.S. dollar balances of the MTIP cash and investments are disclosed by currency and investment type in the following table and Note 8 Year End Portfolio for 2005.

#### MTIP Cash by Currency

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Cash</b>				
Australian Dollar	\$ 132,457	\$ 129,655	\$ 341,641	\$ 337,246
Hong Kong Dollar	124,923	124,949	94,269	94,237
France Euro	54	54	123	123
Japanese Yen	1,458,770	1,437,714	1,081,579	1,074,658
South Korean Won	4,185	4,085	4,043	4,047
Malaysian Ringgit	7,189	7,189	6,503	6,503
New Zealand Dollar	69,938	67,755	0	0
Philippine Peso	2,728	2,664	0	0
Singapore Dollar	1,233	1,219	34,154	33,981
Swiss Franc	0	0	87,862	88,171
New Taiwan Dollar	194,741	193,214	153,158	152,433
<b>Total Cash</b>	<b>\$ 1,996,217</b>	<b>\$ 1,968,498</b>	<b>\$ 1,803,332</b>	<b>\$ 1,791,399</b>

#### MTIP Investment by Security Type

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Security Investment Type</b>				
BGI MSCI Europe Index	\$ 384,025,081	\$ 466,246,669	\$ 375,433,656	\$ 389,187,569
BOI MSCI Pacific Index	40,005,322	50,628,249	40,005,322	46,167,852
BGI Cash and Money Market	1	1	781	781
DFA International Small Company	75,484,090	76,554,040	0	0
SPIFF	2,123,299	2,111,305	31,374,029	31,685,217
Schroder Investment Management	120,403,317	137,133,726	131,738,148	150,236,944
Pyford International	124,335,445	149,790,197	119,716,997	133,028,120
Nomura Asset Management U.S.A., Inc.	93,755,428	111,054,432	88,213,470	103,630,876
<b>Total Investments</b>	<b>\$ 840,131,984</b>	<b>\$ 993,518,620</b>	<b>\$ 786,482,403</b>	<b>\$ 853,937,359</b>
<b>Securities Lending Collateral Investment Pool</b>	<b>34,537,173</b>	<b>34,537,173</b>	<b>43,804,312</b>	<b>43,804,312</b>

The MTIP, through the above funds, has significant investments in 19 foreign countries. Future economic and political developments in these countries could adversely affect the liquidity or value, or both, of the securities held by the above funds in which MTIP is invested.

### 5. SUBSEQUENT EVENT

On August 1, 2005, the Board sold Schroders Investment Management NA units for \$25 million generating a gain of \$5.1 million. The Board subsequently purchased \$10 million in the DFA International Small Company Portfolio.

## 6. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 7. RESTATEMENT

The June 30, 2004 Cash balance has been restated from the previously stated carrying amount of \$1,803,332 to \$1,791,399 to reflect the fair value of the U.S. dollar cash deposits. The June 30, 2004 Unrealized Foreign Exchange Market Gain (Loss) of \$29,339 has been restated to \$17,403 to recognize the reporting of cash at fair value.

## 8. YEAR END PORTFOLIO

The combined investment portfolios for the six funds, as of June 30, 2005 are listed below by currency. The percent is based on the total fair value of each security/country to the combined total portfolio fair value.

<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
AUSTRALIAN DOLLAR	ALUMINA LIMITED	107,899	441,381	457,750	0.05%
AUSTRALIAN DOLLAR	AMCOR LIMITED	132,833	580,662	678,388	0.07%
AUSTRALIAN DOLLAR	AUSTRALIA / NEW ZEALAND BANK	77,797	934,989	1,288,776	0.13%
AUSTRALIAN DOLLAR	BHP BILLITON LTD	306,410	1,660,020	4,237,464	0.43%
AUSTRALIAN DOLLAR	BRADKEN LTD	62,948	122,193	138,559	0.01%
AUSTRALIAN DOLLAR	BRAMBLES INDUSTRIES LTD	107,170	551,485	667,410	0.07%
AUSTRALIAN DOLLAR	CFS GANDEL	448,421	557,370	572,079	0.06%
AUSTRALIAN DOLLAR	COCA COLA AMATIL	95,600	360,050	574,953	0.06%
AUSTRALIAN DOLLAR	COMMONWEALTH BK OF AUSTRALIA	76,700	1,634,876	2,217,970	0.22%
AUSTRALIAN DOLLAR	FOODLAND ASSOC	14,920	203,854	308,528	0.03%
AUSTRALIAN DOLLAR	FOSTERS GROUP	395,300	1,407,876	1,603,008	0.16%
AUSTRALIAN DOLLAR	INSURANCE AUSTRALIA GROUP	211,252	741,513	967,010	0.10%
AUSTRALIAN DOLLAR	LEND LEASE CORP	52,241	372,267	516,076	0.05%
AUSTRALIAN DOLLAR	MACQUARIE INFRASTRUCTURE	236,700	460,885	750,566	0.08%
AUSTRALIAN DOLLAR	MIRVAC GROUP	66,000	173,682	179,460	0.02%
AUSTRALIAN DOLLAR	NATIONAL AUSTRALIA BANK	127,849	2,711,857	2,997,144	0.30%
AUSTRALIAN DOLLAR	NEWCREST MINING	11,334	150,390	150,034	0.02%
AUSTRALIAN DOLLAR	ORIGIN ENERGY	56,000	322,930	324,585	0.03%
AUSTRALIAN DOLLAR	PUBLISHING + BROADCASTING LTD	38,173	465,750	431,756	0.04%
AUSTRALIAN DOLLAR	RINKER GROUP	166,983	1,012,376	1,781,014	0.18%
AUSTRALIAN DOLLAR	RIO TINTO LIMITED	92,319	2,102,604	3,152,959	0.32%
AUSTRALIAN DOLLAR	SONIC HEALTHCARE LTD	37,900	340,004	363,138	0.04%
AUSTRALIAN DOLLAR	TABCORP HOLDINGS LTD	113,591	1,190,544	1,419,349	0.14%
AUSTRALIAN DOLLAR	TELSTRA CORP	161,394	520,327	622,004	0.06%
AUSTRALIAN DOLLAR	WESTFIELD GROUP	44,176	420,908	596,892	0.06%
AUSTRALIAN DOLLAR	WESTPAC BANKING CORP	291,200	3,049,057	4,426,629	0.45%
AUSTRALIAN DOLLAR	WOODSIDE PETROLEUM	20,024	198,765	446,100	0.04%

<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
AUSTRALIAN DOLLAR	WOOLWORTHS LTD	131,800	1,232,540	1,658,333	0.17%
<b>AUSTRALIAN DOLLAR 28 ISSUE(S)</b>		<b>3,684,934</b>	<b>23,921,155</b>	<b>33,527,931</b>	<b>3.37%</b>
FRANCE EURO	AIR LIQUIDE	11,881	1,993,586	2,026,667	0.20%
FRANCE EURO	CNP ASSURANCES	46,200	2,081,081	2,958,803	0.30%
FRANCE EURO	DEXIA	203,340	2,495,673	4,482,818	0.45%
FRANCE EURO	DEXIA STRIPS	129,140	0	1,563	0.00%
FRANCE EURO	TOTAL SA	24,900	3,538,744	5,857,206	0.59%
FRANCE EURO	VALEO	47,499	1,858,468	2,133,422	0.21%
FRANCE EURO	VEOLIA ENVIRONNEMENT	18,300	364,903	688,352	0.07%
<b>FRANCE EURO 7 ISSUE(S)</b>		<b>481,260</b>	<b>12,332,455</b>	<b>18,148,832</b>	<b>1.83%</b>
GERMANY EURO	HENKEL	6,900	396,625	618,325	0.06%
GERMANY EURO	SCHERING AG	42,600	2,054,357	2,624,068	0.26%
<b>GERMANY EURO 2 ISSUE(S)</b>		<b>49,500</b>	<b>2,450,982</b>	<b>3,242,393</b>	<b>0.33%</b>
HONG KONG DOLLAR	CHINA LIFE INSURANCE	430,000	288,955	293,226	0.03%
HONG KONG DOLLAR	CHINA MOBILE	202,500	562,682	754,280	0.08%
HONG KONG DOLLAR	CHINA OILFIELD SERVICE	740,000	248,723	273,734	0.03%
HONG KONG DOLLAR	CHINA TELECOM CORP	1,652,000	503,476	595,063	0.06%
HONG KONG DOLLAR	COSCO PACIFIC LTD	558,000	1,059,054	1,083,993	0.11%
HONG KONG DOLLAR	LI + FUNG	646,000	994,917	1,342,170	0.14%
HONG KONG DOLLAR	MTR CORP	218,243	339,199	421,202	0.04%
HONG KONG DOLLAR	PING AN INSURANCE	430,500	575,734	692,274	0.07%
HONG KONG DOLLAR	ZIJIN MINING GROUP CO LTD	500,000	90,296	110,008	0.01%
HONG KONG DOLLAR	CHEUNG KONG HOLDINGS	263,000	2,204,636	2,563,082	0.26%
HONG KONG DOLLAR	CHINA OVERSEAS LAND	1,248,000	244,537	231,226	0.02%
HONG KONG DOLLAR	CHINA PETROLEUM + CHEMICAL	740,000	220,529	290,396	0.03%
HONG KONG DOLLAR	CHINA ST CONSTRUCTION INTL	69,333	0	0	0.00%
HONG KONG DOLLAR	CLP HOLDINGS	131,736	609,312	755,959	0.08%
HONG KONG DOLLAR	CNOOC LTD	1,339,000	512,326	801,027	0.08%
HONG KONG DOLLAR	HANG SENG BANK	62,598	829,594	853,739	0.09%
HONG KONG DOLLAR	HOPEWELL HIGHWAY	392,000	248,014	282,444	0.03%
HONG KONG DOLLAR	SUN HUNG KAI PROPS	180,520	1,469,447	1,782,505	0.18%
HONG KONG DOLLAR	SWIRE PACIFIC	193,500	1,077,774	1,711,462	0.17%
HONG KONG DOLLAR	WHARF HOLDINGS	348,000	976,990	1,222,218	0.12%
<b>HONG KONG DOLLAR 20 ISSUE(S)</b>		<b>10,344,930</b>	<b>13,056,195</b>	<b>16,060,009</b>	<b>1.62%</b>
INDONESIAN RUPIAH	TELEKOMUNIKASI IND	1,948,500	696,380	998,207	0.10%
<b>INDONESIAN RUPIAH 1 ISSUE(S)</b>		<b>1,948,500</b>	<b>696,380</b>	<b>998,207</b>	<b>0.10%</b>
IRELAND EURO	ANGLO IRISH BANK	109,800	1,402,809	1,362,525	0.14%
IRELAND EURO	BANK OF IRELAND	307,100	3,847,507	4,989,427	0.50%
IRELAND EURO	IRISH LIFE + PERM	96,200	1,743,339	1,685,241	0.17%
<b>IRELAND EURO 3 ISSUE(S)</b>		<b>513,100</b>	<b>6,993,655</b>	<b>8,037,194</b>	<b>0.81%</b>
JAPANESE YEN	AISIN SEIKI CO	55,000	848,954	1,192,634	0.12%
JAPANESE YEN	AJINOMOTO CO INC	99,000	1,033,447	1,103,375	0.11%
JAPANESE YEN	ALPS ELECTRIC CO	15,000	200,105	229,646	0.02%
JAPANESE YEN	AMADA CO	59,000	343,161	401,632	0.04%
JAPANESE YEN	ASAHI GLASS CO	92,000	1,003,656	968,071	0.10%
JAPANESE YEN	ASAHI KASEI CORP	200,000	943,225	952,123	0.10%
JAPANESE YEN	ASTELLAS PHARMA INC	97,300	3,214,518	3,327,922	0.33%
JAPANESE YEN	BANDAI CO	9,700	245,623	195,907	0.02%
JAPANESE YEN	BANK OF YOKOHAMA	94,000	405,767	543,760	0.05%
JAPANESE YEN	BRIDGESTONE CORP	162,000	2,207,735	3,120,698	0.31%
JAPANESE YEN	CANON INC	25,500	1,274,217	1,343,922	0.14%
JAPANESE YEN	CANON SALES CO INC	26,000	202,301	438,373	0.04%
JAPANESE YEN	CENTRAL GLASS CO	76,000	446,881	474,872	0.05%
JAPANESE YEN	CITIZEN WATCH CO	31,000	225,354	280,624	0.03%

<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
JAPANESE YEN	CREDIT SAISON CO	30,000	585,916	998,107	0.10%
JAPANESE YEN	DAICEL CHEM INDS	27,000	138,627	142,169	0.01%
JAPANESE YEN	DAIDO STEEL CO	164,000	269,292	739,338	0.07%
JAPANESE YEN	DAIKIN INDUSTRIES	63,300	1,398,001	1,584,265	0.16%
JAPANESE YEN	DENKI KAGAKU KOGYO	220,000	656,793	791,453	0.08%
JAPANESE YEN	DOWA MINING CO	182,000	858,252	1,214,318	0.12%
JAPANESE YEN	EAST JAPAN RAILWAY	807	3,931,250	4,151,160	0.42%
JAPANESE YEN	ELECTRIC POWER DEVELOPMENT	38,700	1,059,142	1,121,081	0.11%
JAPANESE YEN	ELPIDA MEMORY INC	8,600	289,131	277,594	0.03%
JAPANESE YEN	FANUC	13,800	869,084	877,198	0.09%
JAPANESE YEN	FAST RETAILING CO	15,600	873,337	810,170	0.08%
JAPANESE YEN	FUJI PHOTO FILM CO	126,100	3,730,863	4,060,279	0.41%
JAPANESE YEN	FUJI SEAL INTERNATIONAL INC	9,300	298,546	295,425	0.03%
JAPANESE YEN	FUJIKURA	101,000	453,894	493,571	0.05%
JAPANESE YEN	FUJITSU	172,000	1,020,026	903,384	0.09%
JAPANESE YEN	FUNAI ELECTRIC CO	11,200	1,341,545	1,149,703	0.12%
JAPANESE YEN	GLORY	7,000	76,276	112,192	0.01%
JAPANESE YEN	HISAMITSU PHARMACEUTICALS CO	9,000	103,814	239,789	0.02%
JAPANESE YEN	HITACHI CHEMICAL	8,600	127,091	157,795	0.02%
JAPANESE YEN	HITACHI HIGH TECH	13,300	207,729	203,020	0.02%
JAPANESE YEN	HITACHI METALS	50,000	213,231	350,284	0.04%
JAPANESE YEN	HITACHI TRANSPORT SYSTEM	135,000	759,476	1,175,661	0.12%
JAPANESE YEN	HONDA MOTOR CO	97,000	3,820,449	4,786,012	0.48%
JAPANESE YEN	HOYA CORP	3,700	423,992	427,398	0.04%
JAPANESE YEN	ITO YOKADO CO	20,600	657,840	684,126	0.07%
JAPANESE YEN	ITOCHU CORP	229,000	565,836	1,158,318	0.12%
JAPANESE YEN	ITOCHU TECHNO SCIE	5,500	149,631	192,904	0.02%
JAPANESE YEN	JAPAN AIRPORT TERMINAL	103,000	791,446	955,546	0.10%
JAPANESE YEN	JFE HOLDING INC	84,000	1,482,460	2,075,196	0.21%
JAPANESE YEN	JS GROUP CORP	51,600	845,378	873,725	0.09%
JAPANESE YEN	KAKEN PHARM	9,000	61,290	61,834	0.01%
JAPANESE YEN	KAMIGUMI CO	84,000	565,380	648,309	0.07%
JAPANESE YEN	KANEKA CORP	94,000	807,329	1,056,132	0.11%
JAPANESE YEN	KDDI CORP	215	1,166,319	995,352	0.10%
JAPANESE YEN	KEIHIN CORP	29,000	275,998	474,835	0.05%
JAPANESE YEN	KEYENCE CORP	2,000	424,491	448,291	0.05%
JAPANESE YEN	KONICA MINOLTA HOLDINGS INC	87,500	934,384	817,329	0.08%
JAPANESE YEN	KURARAY CO	121,000	935,209	1,147,649	0.12%
JAPANESE YEN	KYORIN PHARMACEUTICALS	23,000	296,803	276,846	0.03%
JAPANESE YEN	LEOPALACE21	15,900	305,396	264,212	0.03%
JAPANESE YEN	MABUCHI MOTOR CO	9,700	698,555	559,363	0.06%
JAPANESE YEN	MARUI CO	66,000	1,007,492	890,443	0.09%
JAPANESE YEN	MATSUSHITA ELECTRIC IND	71,000	1,065,365	1,078,359	0.11%
JAPANESE YEN	MISUMI GROUP INC	3,800	116,911	120,945	0.01%
JAPANESE YEN	MITSUBISHI CORP	73,100	683,792	994,809	0.10%
JAPANESE YEN	MITSUBISHI ELECTRIC	199,000	661,834	1,055,970	0.11%
JAPANESE YEN	MITSUBISHI ESTATE	124,000	1,433,721	1,366,339	0.14%
JAPANESE YEN	MITSUBISHI TOKYO FINANCIAL	512	4,713,822	4,345,461	0.44%
JAPANESE YEN	mitsui + co	264,000	1,592,620	2,501,579	0.25%
JAPANESE YEN	mitsui FUDOSAN CO	102,000	898,473	1,144,982	0.12%
JAPANESE YEN	mitsui MINING + SM	20,000	92,905	93,950	0.01%
JAPANESE YEN	mitsui SUMITOMO INSURANCE CO	89,000	498,854	801,650	0.08%
JAPANESE YEN	mitsukoshi LTD	67,000	340,916	302,047	0.03%
JAPANESE YEN	MURATA MFG CO	35,800	1,909,306	1,825,377	0.18%
JAPANESE YEN	NAMCO	28,800	375,419	383,273	0.04%

<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
JAPANESE YEN	NGK SPARK PLUG CO	59,000	460,278	680,995	0.07%
JAPANESE YEN	NICHICON CORP	18,400	1,108,388	256,648	0.03%
JAPANESE YEN	NIHON UNISYS	3,500	32,728	34,808	0.00%
JAPANESE YEN	NINTENDO CO	8,000	671,005	836,714	0.08%
JAPANESE YEN	NIPPON CABLE SYSTEM	16,000	142,971	199,549	0.02%
JAPANESE YEN	NIPPON ELECTRIC GLASS	80,000	707,045	1,208,908	0.12%
JAPANESE YEN	NIPPON OIL CORP	179,000	894,444	1,215,283	0.12%
JAPANESE YEN	NIPPON PAPER GROUP INC	345	1,735,995	1,267,169	0.13%
JAPANESE YEN	NIPPON SHEET GLASS	143,000	602,936	559,571	0.06%
JAPANESE YEN	NIPPON SUISAN	59,000	118,217	222,360	0.02%
JAPANESE YEN	NIPPON TEL+TEL	810	4,865,577	3,470,625	0.35%
JAPANESE YEN	NIPPON TV NETWORK	6,140	1,179,798	836,139	0.08%
JAPANESE YEN	NIPPON YUSEN	108,000	391,720	621,260	0.06%
JAPANESE YEN	NIPPON ZEON CO	41,000	320,274	354,513	0.04%
JAPANESE YEN	NISHIMATSUYA CHAIN	6,100	150,924	163,349	0.02%
JAPANESE YEN	NISSAN MOTOR CO	295,600	3,128,852	2,926,416	0.29%
JAPANESE YEN	NISSIN CO LTD	120,480	148,262	225,948	0.02%
JAPANESE YEN	NITTO DENKO CORP	13,000	628,047	746,142	0.08%
JAPANESE YEN	NOMURA HOLDINGS	119,800	1,655,202	1,434,659	0.14%
JAPANESE YEN	NTT DOCOMO	560	1,382,919	828,806	0.08%
JAPANESE YEN	OMRON CORP	75,800	1,353,432	1,672,512	0.17%
JAPANESE YEN	ONO PHARMACEUTICAL	7,600	309,178	360,436	0.04%
JAPANESE YEN	ORIENTAL LAND CO LTD	6,400	418,138	380,038	0.04%
JAPANESE YEN	ORIX CORP	10,400	631,057	1,560,328	0.16%
JAPANESE YEN	PARIS MIKI INC	9,000	141,089	194,753	0.02%
JAPANESE YEN	PROMISE CO	24,400	1,296,591	1,565,599	0.16%
JAPANESE YEN	RICOH CO	139,000	2,450,426	2,173,874	0.22%
JAPANESE YEN	ROHM CO	43,300	5,248,377	4,178,709	0.42%
JAPANESE YEN	SANKEN ELECTRIC CO	44,000	396,850	574,051	0.06%
JAPANESE YEN	SANKYO CO	13,900	242,956	266,946	0.03%
JAPANESE YEN	SANKYO TATETAMA HO	87,000	288,308	215,715	0.02%
JAPANESE YEN	SANYO SHOKAI	55,000	357,116	284,645	0.03%
JAPANESE YEN	SAPPORO HOKUYO HOLDINGS	25	169,916	192,724	0.02%
JAPANESE YEN	SEIKO CORPORATION	19,000	90,125	103,129	0.01%
JAPANESE YEN	SEKISUI CHEMICAL	140,000	944,002	965,256	0.10%
JAPANESE YEN	SEVEN ELEVEN JAPAN	28,000	840,190	777,567	0.08%
JAPANESE YEN	SHIMACHU CO	12,500	292,539	314,444	0.03%
JAPANESE YEN	SHIMADZU CORP	62,000	314,856	390,190	0.04%
JAPANESE YEN	SHIMANO INC	13,800	266,345	391,939	0.04%
JAPANESE YEN	SHIN ETSU CHEMICAL CO	42,200	1,559,171	1,603,303	0.16%
JAPANESE YEN	SHIONOGI + CO	45,000	625,306	580,606	0.06%
JAPANESE YEN	SHOWA DENKO	338,000	697,275	801,497	0.08%
JAPANESE YEN	SHOWA SHELL SEKIYU	73,500	480,412	736,260	0.07%
JAPANESE YEN	SMC CORP	11,400	1,109,509	1,244,834	0.13%
JAPANESE YEN	SOHGO SECURITY SERVICES	26,400	331,722	349,905	0.04%
JAPANESE YEN	SOMPO JAPAN INSURANCE	134,000	762,599	1,354,390	0.14%
JAPANESE YEN	STANLEY ELECTRIC	52,800	869,163	856,911	0.09%
JAPANESE YEN	SUMITOMO BAKELITE	52,000	296,107	336,937	0.03%
JAPANESE YEN	SUMITOMO ELEC INDS	216,000	1,842,340	2,213,877	0.22%
JAPANESE YEN	SUMITOMO MITSUI	597	3,890,519	4,038,424	0.41%
JAPANESE YEN	SUMITOMO TRUST+BKG	194,000	1,105,049	1,180,687	0.12%
JAPANESE YEN	SUZUKEN CO LTD	19,600	525,263	494,378	0.05%
JAPANESE YEN	T+D HOLDINGS INC	30,950	1,386,779	1,457,466	0.15%
JAPANESE YEN	TAIYO YUDEN CO	56,000	605,390	621,044	0.06%
JAPANESE YEN	TAKASHIMAYA CO	80,000	567,089	716,903	0.07%

<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
JAPANESE YEN	TAKEDA PHARMACEUTICAL CO LTD	84,500	3,344,781	4,194,116	0.42%
JAPANESE YEN	TANABE SEIYAKU CO	27,000	222,836	260,481	0.03%
JAPANESE YEN	TDK CORP	8,100	513,570	552,123	0.06%
JAPANESE YEN	THK CO	60,800	1,102,181	1,255,960	0.13%
JAPANESE YEN	TIS INC	8,400	253,317	287,044	0.03%
JAPANESE YEN	TOHO CO	58,500	509,371	844,689	0.09%
JAPANESE YEN	TOKAI RUBBER I	12,000	157,504	161,320	0.02%
JAPANESE YEN	TOKYO GAS CO	147,000	512,025	550,041	0.06%
JAPANESE YEN	TOKYO SEIMITSU CO	27,800	834,763	1,122,929	0.11%
JAPANESE YEN	TOYO SEIKAN KAISHA	27,600	382,058	436,235	0.04%
JAPANESE YEN	TOYO SUISAN KAISHA	24,000	247,875	375,656	0.04%
JAPANESE YEN	TOYOTA INDUSTRIES	22,200	414,667	607,039	0.06%
JAPANESE YEN	TOYOTA MOTOR CORP	135,700	3,827,176	4,861,736	0.49%
JAPANESE YEN	TOYS R US	9,000	154,576	131,539	0.01%
JAPANESE YEN	UNITED ARROWS LTD	10,000	195,374	314,670	0.03%
JAPANESE YEN	USHIO INC	11,000	186,807	195,880	0.02%
JAPANESE YEN	VICTOR CO OF JAPAN	134,000	1,128,875	925,471	0.09%
JAPANESE YEN	YAMAHA CORP	71,600	1,208,506	1,116,833	0.11%
JAPANESE YEN	YAMATO TRANSPORT	37,000	417,311	514,063	0.05%
JAPANESE YEN	YORK BENIMARU CO	21,600	498,263	592,582	0.06%
<b>JAPANESE YEN 144 ISSUE(S)</b>		<b>9,040,641</b>	<b>131,598,475</b>	<b>143,770,620</b>	<b>14.47%</b>
MALAYSIAN RINGGIT	GENTING BERHAD	137,722	602,677	684,986	0.07%
MALAYSIAN RINGGIT	IOI CORP	60,000	114,598	165,789	0.02%
MALAYSIAN RINGGIT	LAFARGE MALAYAN CEMENT	3,584,500	773,803	570,690	0.06%
MALAYSIAN RINGGIT	MALAYAN BANK	122,300	310,850	350,808	0.04%
MALAYSIAN RINGGIT	MALAYSIA INTERNATIONAL SHIP	52,000	165,672	244,947	0.02%
MALAYSIAN RINGGIT	MAXIS COMMUN	74,000	147,957	188,895	0.02%
MALAYSIAN RINGGIT	PLUS EXPRESSWAYS B	180,000	121,195	155,368	0.02%
MALAYSIAN RINGGIT	PUBLIC BANK	135,900	209,673	239,613	0.02%
MALAYSIAN RINGGIT	SP SETIA	230,000	219,721	246,947	0.02%
MALAYSIAN RINGGIT	TELEKOM MALAYSIA	376,100	1,014,982	989,737	0.10%
MALAYSIAN RINGGIT	YTL POWER INTL	180,000	94,161	94,737	0.01%
<b>MALAYSIAN RINGGIT 11 ISSUE(S)</b>		<b>5,132,522</b>	<b>3,775,289</b>	<b>3,932,518</b>	<b>0.40%</b>
NETHERLANDS EURO	AEGON NV	105,423	1,701,931	1,366,920	0.14%
NETHERLANDS EURO	REED ELSEVIER NV	195,900	2,507,993	2,732,155	0.27%
NETHERLANDS EURO	ROYAL DUTCH PETROL	105,900	5,151,755	6,923,219	0.70%
NETHERLANDS EURO	TNT NV	122,300	2,333,240	3,101,908	0.31%
NETHERLANDS EURO	VNU NV	103,000	2,830,187	2,876,757	0.29%
<b>NETHERLANDS EURO 5 ISSUE(S)</b>		<b>632,523</b>	<b>14,525,106</b>	<b>17,000,959</b>	<b>1.71%</b>
NEW TAIWAN DOLLAR	ACER INC	277,000	449,700	547,595	0.06%
NEW TAIWAN DOLLAR	ADVANCED SEMICONDUCTOR	380,000	269,210	284,595	0.03%
NEW TAIWAN DOLLAR	ADVANTECH	152,975	343,181	362,557	0.04%
NEW TAIWAN DOLLAR	AU OPTRONICS CORP	58,590	817,331	992,515	0.10%
NEW TAIWAN DOLLAR	AU OPTRONICS CORP	168,000	275,604	281,103	0.03%
NEW TAIWAN DOLLAR	CATHAY FINANCIAL	237,000	422,926	478,265	0.05%
NEW TAIWAN DOLLAR	CATHAY FINANCIAL HLDG LTD	68,099	1,020,746	1,370,833	0.14%
NEW TAIWAN DOLLAR	CHINA STEEL	6,000	121,200	120,600	0.01%
NEW TAIWAN DOLLAR	CHINA STEEL	29,462	376,047	592,186	0.06%
NEW TAIWAN DOLLAR	CHINA TRUST FINANCE	1,409,800	1,567,826	1,537,837	0.15%
NEW TAIWAN DOLLAR	DELTA ELECTRONICS	178,200	229,628	276,775	0.03%
NEW TAIWAN DOLLAR	FAR EASTONE TELECOMMUNIC	45,500	808,204	864,500	0.09%
NEW TAIWAN DOLLAR	FORMOSA PLASTIC	490,500	712,170	802,904	0.08%
NEW TAIWAN DOLLAR	FUBON FINANCIAL HOLDING CO LTD	117,275	1,143,780	1,131,704	0.11%
NEW TAIWAN DOLLAR	GIANT MANUFACTURING	188,000	327,308	303,580	0.03%
NEW TAIWAN DOLLAR	HON HAI PRECISION	77,049	298,885	400,897	0.04%

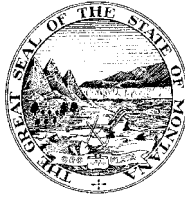


<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
NEW TAIWAN DOLLAR	HON HAI PRECISION IND LTD	144,635	1,015,988	1,496,972	0.15%
NEW TAIWAN DOLLAR	MERRY ELECTRONICS	80,723	188,146	215,550	0.02%
NEW TAIWAN DOLLAR	POLARIS SECURITIES	1,353,000	702,547	674,029	0.07%
NEW TAIWAN DOLLAR	QUANTA COMPUTER	214,000	369,575	409,133	0.04%
NEW TAIWAN DOLLAR	TAISHIN FINANCIAL	350,000	316,660	293,648	0.03%
NEW TAIWAN DOLLAR	TAIWAN SECOM CO	290,000	320,808	449,044	0.05%
NEW TAIWAN DOLLAR	TAIWAN SEMICONDUCTOR	1,065,980	1,675,607	1,857,104	0.19%
NEW TAIWAN DOLLAR	UNITED MICRO	1,546,000	1,058,146	1,124,438	0.11%
NEW TAIWAN DOLLAR	UNITED MICROELECTRONICS CORP	83,896	273,812	344,813	0.03%
<b>NEW TAIWAN DOLLAR 25 ISSUE(S)</b>		<b>9,011,684</b>	<b>15,105,035</b>	<b>17,213,176</b>	<b>1.73%</b>
NEW ZEALAND DOLLAR	FLETCHER BUILDING	43,000	124,336	206,713	0.02%
NEW ZEALAND DOLLAR	TELECOM CORP OF NZ	138,676	554,491	579,826	0.06%
<b>NEW ZEALAND DOLLAR 2 ISSUE(S)</b>		<b>181,676</b>	<b>678,827</b>	<b>786,540</b>	<b>0.08%</b>
PHILIPPINE PESO	AYALA LAND INC	7,987,976	988,387	1,114,530	0.11%
PHILIPPINE PESO	BANK OF PHILIPPINES ISLANDS	1,023,800	873,298	888,164	0.09%
<b>PHILIPPINE PESO 2 ISSUE(S)</b>		<b>9,011,776</b>	<b>1,861,685</b>	<b>2,002,694</b>	<b>0.20%</b>
PORTUGAL EURO	BRISA AUTO ESTRADA	166,900	1,327,808	1,311,352	0.13%
<b>PORTUGAL EURO 1 ISSUE(S)</b>		<b>166,900</b>	<b>1,327,808</b>	<b>1,311,352</b>	<b>0.13%</b>
POUND STERLING	ASTRO ALL ASIA	457,800	646,678	656,582	0.07%
POUND STERLING	BOOTS GROUP	78,000	836,223	851,449	0.09%
POUND STERLING	BP PLC	402,000	3,111,603	4,186,479	0.42%
POUND STERLING	BRITISH SKY BROADCAST	262,600	3,133,480	2,482,927	0.25%
POUND STERLING	COMPASS GROUP	906,000	5,182,577	3,808,183	0.38%
POUND STERLING	EXEL	142,100	1,673,505	2,162,462	0.22%
POUND STERLING	GALLAHER GROUP	281,900	2,634,417	4,188,865	0.42%
POUND STERLING	GLAXOSMITHKLINE	211,000	4,754,206	5,109,572	0.51%
POUND STERLING	HSBC HLDGS	83,600	1,127,403	1,344,380	0.14%
POUND STERLING	LEGAL + GENERAL	2,265,740	4,008,489	4,670,406	0.47%
POUND STERLING	RENTOKIL INITIAL	407,300	1,219,753	1,166,278	0.12%
POUND STERLING	SCOTTISH + SOUTHERN ENERGY	122,000	1,163,096	2,215,216	0.22%
POUND STERLING	TANJONG	70,800	200,904	244,074	0.02%
POUND STERLING	TOMKINS	405,837	1,608,059	1,902,261	0.19%
POUND STERLING	UNILEVER	130,064	1,142,243	1,255,422	0.13%
POUND STERLING	UNITED UTILITIES	296,000	2,636,756	3,501,728	0.35%
POUND STERLING	VODAFONE GROUP	1,889,544	3,619,694	4,606,199	0.46%
<b>POUND STERLING 17 ISSUE(S)</b>		<b>8,412,285</b>	<b>38,699,087</b>	<b>44,352,481</b>	<b>4.46%</b>
SINGAPORE DOLLAR	OVERSEAS CHINESE BANK	5,600	0	21,410	0.00%
SINGAPORE DOLLAR	CITY DEVELOPMENTS	48,000	174,196	213,390	0.02%
SINGAPORE DOLLAR	DBS GROUP HOLDINGS	181,266	1,434,022	1,536,292	0.15%
SINGAPORE DOLLAR	KEPPEL LAND LTD	156,000	156,381	231,173	0.02%
SINGAPORE DOLLAR	MOBILEONE	520,560	418,704	672,566	0.07%
SINGAPORE DOLLAR	OVERSEAS CHINESE BANK	28,000	188,157	192,525	0.02%
SINGAPORE DOLLAR	SINGAPORE AIRLINES	24,000	164,308	159,331	0.02%
SINGAPORE DOLLAR	SINGAPORE PRESS	351,768	952,062	896,491	0.09%
SINGAPORE DOLLAR	SINGAPORE TECH	120,000	144,839	172,135	0.02%
SINGAPORE DOLLAR	SINGAPORE TELECOMM	657,580	929,234	1,079,576	0.11%
SINGAPORE DOLLAR	SMRT CORPORATION	147,000	73,574	102,819	0.01%
SINGAPORE DOLLAR	UNITED OVERSEAS BANK	175,576	1,188,079	1,477,700	0.15%
SINGAPORE DOLLAR	UTD OVERSEAS LAND	17,557	18,694	23,726	0.00%
SINGAPORE DOLLAR	VENTURE CORP LTD	27,888	253,246	264,490	0.03%
<b>SINGAPORE DOLLAR 14 ISSUE(S)</b>		<b>2,460,795</b>	<b>6,095,494</b>	<b>7,043,624</b>	<b>0.71%</b>
SOUTH KOREAN WON	CHEIL COMMUNICATION	1,200	188,302	225,835	0.02%
SOUTH KOREAN WON	DAEWOO SHIPBUILDING + MARINE	28,790	474,931	552,957	0.06%
SOUTH KOREAN WON	HANA BANK	13,950	336,358	373,890	0.04%

<u>Country</u>	<u>Security Name</u>	<u>Shares</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
SOUTH KOREAN WON	HANKOOK TIRE	101,410	1,182,454	1,226,536	0.12%
SOUTH KOREAN WON	HYUNDAI MOTOR CO	20,079	746,945	1,117,119	0.11%
SOUTH KOREAN WON	KOOKMIN BANK	25,600	1,181,407	1,165,438	0.12%
SOUTH KOREAN WON	KT + G CORPORATION	19,862	338,308	778,337	0.08%
SOUTH KOREAN WON	KT CORPORATION	4,069	160,486	165,358	0.02%
SOUTH KOREAN WON	LG CHEMICAL	12,320	551,790	450,601	0.05%
SOUTH KOREAN WON	POSCO	3,261	346,568	575,842	0.06%
SOUTH KOREAN WON	SAMSUNG	1,000	104,693	93,953	0.01%
SOUTH KOREAN WON	SAMSUNG ELECTRONIC	12,235	2,941,521	5,848,176	0.59%
SOUTH KOREAN WON	SAMSUNG FIRE + MARINE	15,520	1,152,716	1,259,921	0.13%
SOUTH KOREAN WON	SEOUL SECURITIES	513,450	356,002	403,904	0.04%
SOUTH KOREAN WON	SHINHAN FINANCIAL	22,516	350,320	586,048	0.06%
SOUTH KOREAN WON	SHINSEGAE CO LTD	2,110	361,947	667,605	0.07%
SOUTH KOREAN WON	SK TELECOM	2,703	474,998	476,000	0.05%
<b>SOUTH KOREAN WON</b>	<b>17 ISSUE(S)</b>	<b>800,075</b>	<b>11,249,747</b>	<b>15,967,519</b>	<b>1.61%</b>
SPAIN EURO	BBVA	302,900	3,419,211	4,679,165	0.47%
SPAIN EURO	ENAGAS SA	122,200	1,068,080	2,167,341	0.22%
SPAIN EURO	ENDESA S.A.	182,700	2,393,443	4,293,213	0.43%
SPAIN EURO	RED ELECTRICA DE ESPANA	94,100	1,628,435	2,607,677	0.26%
SPAIN EURO	TELEFONICA SA	422,093	5,009,893	6,919,030	0.70%
SPAIN EURO	TPI TELEPHONE	200,700	1,400,156	1,756,726	0.18%
<b>SPAIN EURO</b>	<b>6 ISSUE(S)</b>	<b>1,324,693</b>	<b>14,919,219</b>	<b>22,423,151</b>	<b>2.26%</b>
SWISS FRANC	NESTLE SA	28,130	6,240,598	7,202,123	0.72%
SWISS FRANC	NOVARTIS AG	185,600	7,185,530	8,844,649	0.89%
SWISS FRANC	ROCHE HOLDINGS AG	43,710	3,837,287	5,534,121	0.56%
SWISS FRANC	SWATCH GROUP	7,000	744,771	983,530	0.10%
SWISS FRANC	SWISS REINSURANCE	96,600	7,250,055	5,941,831	0.60%
SWISS FRANC	SWISSCOM AG	3,700	1,181,506	1,207,244	0.12%
SWISS FRANC	SYNTHES INC	9,250	601,526	1,015,904	0.10%
SWISS FRANC	ZURICH FIN SVS GRP	16,790	4,125,167	2,893,788	0.29%
<b>SWISS FRANC</b>	<b>8 ISSUE(S)</b>	<b>390,780</b>	<b>31,166,439</b>	<b>33,623,190</b>	<b>3.38%</b>
THAILAND BAHT	BANGKOK BANK	97,600	198,245	238,452	0.02%
THAILAND BAHT	BANGKOK BANK	332,300	894,612	868,548	0.09%
THAILAND BAHT	KASIKORNBANK PCL	120,000	169,110	159,652	0.02%
THAILAND BAHT	KASIKORNBANK PCL	253,100	253,804	336,732	0.03%
THAILAND BAHT	PTT EXPLORTION + PRODUCTION	65,800	305,832	557,088	0.06%
THAILAND BAHT	SIAM CEMENT CO	55,000	262,917	303,338	0.03%
THAILAND BAHT	THAI OIL PLC	283,300	295,856	411,375	0.04%
THAILAND BAHT	TRUE CORPORATION PUBLIC CO LTD	130,895	0	0	0.00%
<b>THAILAND BAHT</b>	<b>8 ISSUE(S)</b>	<b>1,337,995</b>	<b>2,380,376</b>	<b>2,875,184</b>	<b>0.29%</b>
US DOLLAR	BGI CASH	1	1	1	0.00%
US DOLLAR	BGI EQUITY INDEX FUND EUROPE	45,849,990	384,025,081	466,246,669	46.93%
US DOLLAR	BGI PACIFIC INDEX STRATEGY FUND	3,578,423	40,005,322	50,628,249	5.10%
US DOLLAR	DFA INTERNATIONAL SMALL CO	5,218,408	75,484,090	76,554,040	7.71%
<b>US DOLLAR</b>	<b>4 ISSUE(S)</b>	<b>54,646,822</b>	<b>499,514,494</b>	<b>593,428,959</b>	<b>59.73%</b>
<b>EQUITY TOTAL</b>	<b>325 ISSUE(S)</b>	<b>119,573,391</b>	<b>832,347,904</b>	<b>985,746,533</b>	<b>99.22%</b>
US DOLLAR	STATE STREET SPIFF	13,577	2,123,299	2,111,305	0.21%
<b>EQUITY FUTURES TOTAL</b>	<b>1 ISSUE(S)</b>	<b>13,577</b>	<b>2,123,299</b>	<b>2,111,305</b>	<b>0.21%</b>
US DOLLAR	STATE STREET BANK + TRUST CO	5,660,782	5,660,782	5,660,782	0.57%
<b>CASH TOTAL</b>	<b>1 ISSUE(S)</b>	<b>5,660,782</b>	<b>5,660,782</b>	<b>5,660,782</b>	<b>0.57%</b>
<b>MTIP GRAND TOTALS</b>	<b>327 ISSUE(S)</b>	<b>125,247,750</b>	<b>840,131,984</b>	<b>993,518,620</b>	<b>100.00%</b>

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Private Equity Pool, as of June 30, 2005, and 2004, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Private Equity Pool, as of June 30, 2005, and 2004, and its changes in net asset value and investment income and distribution for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

**STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA PRIVATE EQUITY POOL FINANCIAL STATEMENTS**

**STATEMENT OF NET ASSET VALUE JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b><u>Assets</u></b>		
Cash	\$ 0	\$ 0
Dividend/interest receivable	28	1,172,950
Investments managed at fair value (carrying value of \$272,828,932 in 2005 and \$236,711,043 in 2004)(Notes 2 and 4)	<u>297,638,172</u>	<u>258,478,490</u>
<b>Total assets</b>	<b>\$ <u>297,638,200</u></b>	<b>\$ <u>259,651,440</u></b>
<b><u>Liabilities</u></b>		
Income due participants	\$ 209,681	\$ 5,273,616
<b>Total liabilities</b>	<b><u>209,681</u></b>	<b><u>5,273,616</u></b>
<b>Net asset value</b>	<b>\$ <u>297,428,519</u></b>	<b>\$ <u>254,377,824</u></b>
Units Outstanding (Note 2)	2,562,719	2,562,719
Unit Value (Note 2)	\$ 116.06	\$ 99.26

**STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Net asset value, beginning of year	\$ 254,377,824	\$ 298,187,576
Value of units purchased by participants (Notes 1 and 2)	0	0
Value of units sold by participants	0	(33,130,061)
Changes in fair value of investments managed	<u>43,050,695</u>	<u>(10,679,691)</u>
<b>Net asset value, end of year</b>	<b>\$ <u>297,428,519</u></b>	<b>\$ <u>254,377,824</u></b>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

Net realized gains (Note 2)	\$ 0	\$ 76,554,966
Dividend/interest income	2,846,253	5,260,917
Administrative expenses (Note 2)	(3,734,605)	(2,681,882)
Other expenses (Note 2)	(67,925)	0
Income due participants, beginning of year	<u>5,273,616</u>	<u>7,361,863</u>
<b>Income available for distribution</b>	<b>4,317,339</b>	<b>86,495,864</b>
<b>Distribution (Note 2)</b>	<b><u>4,107,658</u></b>	<b><u>81,222,248</u></b>
<b>Income due participants, end of year</b>	<b>\$ <u>209,681</u></b>	<b>\$ <u>5,273,616</u></b>

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA PRIVATE EQUITY POOL

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004

1. HISTORY AND ORGANIZATION

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Montana Private Equity Pool (MPEP) was created by the Board to allow retirement funds, per section 17-6-201, MCA, the opportunity to participate in venture capital and leveraged buyout markets and other private equity investments via a diversified pool. The Board approved creation of the MPEP in April 2002. Effective May 1, 2002, the Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds transferred all their venture capital and leveraged buyout investments, at cost, totaling \$159,799,310, and cash of \$15,000,000 to the MPEP. These investments were previously reported in the All Other Funds financial statements.

Due to the complexity and specialization of private equity investment, the Board contracts with external private equity managers to invest in venture capital, leveraged buyout and other private equity investments. The ten external managers as of June 30, 2005, by Board approval date, are:

<b>Kohlberg, Kravis, Roberts and Company (KKR)</b>	<b>August 1987</b>
Adams Street Partners, formerly Brinson Partners	January 1988
<b>Welsh Carson Anderson and Stowe</b>	<b>September 2000</b>
Madison Dearborn Partners	January 2001
<b>Lexington Partners</b>	<b>May 2001</b>
Oaktree Capital Management	September 2002
<b>ArcLight Energy Partners</b>	<b>April 2004</b>
Inter Mountain Private Equity Partners	October 2004
<b>Odyssey Investment Partners</b>	<b>December 2004</b>
Carlyle Partners	January 2005

In April 2005, the Board approved the staff recommendation that the "Board permanently delegate discretionary investment authority to Staff to negotiate and make binding commitments for MPEP private equity manager participation".

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

MPEP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The MPEP portfolio includes venture capital, leveraged buyout, mezzanine, distressed debt, special situation and secondary investments. Venture capital represents private equity investments in early stage financing of rapidly growing companies with an innovative product or service. Leveraged buyouts (LBO's) permit an investment group to acquire a company by leveraging debt, as a financing technique, to establish a significant ownership position on behalf of the company's current management team. Mezzanine investments are the subordinated debt and/or equity of privately owned companies. The debt holder participates in equity appreciation through conversion features, such as rights, warrants, and/or options. Distressed debt represents the private and public debt of companies that appear unlikely to meet their financial obligations.

This debt is attractive to investors, not for repayment of interest and principal, which are unlikely to be paid, but for the claim placed on the firm's value by unpaid creditors. Without undue principal risk, distressed debt investment managers seek capital appreciation through the sale of restructured debt obligations or newly issued securities. Special situation investments include the investment in the exploration for oil and/or gas reserves or in the development of proven reserves, investment in land to harvest timber, and investments that have a special component usually related to geographical, economic, or social issues. Secondary investments are investments in previously owned limited partnerships. These investments may be direct or via a general partner specializing in secondary investments. Private equity investments are long-term, by design, and extremely illiquid.

MPEP cash is invested in an equity derivative, the State Street Stock Performance Index Futures Fund (SPIFF). Cash is swept daily into SPIFF so MPEP can maintain 100% equity exposure.

Investments are presented in the Statement of Net Asset Value at fair value. Because a recognized market does not exist for private equity investment, MPEP investments, on valuation date, are stated at the fair value reported in the most recent external managers' valuation reports. Carrying value, parenthetically disclosed, represents the private equity security purchase price.

### Participant Units

The nine pension funds transferred all their venture capital and leveraged buyout investments, at cost, into the MPEP at the start-up date and were issued units according to the fair value of each participant's portfolio and cash contribution. The initial unit value as of May 1, 2002 was \$100. Although unit values are calculated at month end, the pool portfolio will be priced at least quarterly at the fair value reported in the external managers' valuation reports. Given the quarterly portfolio valuations, pool participant transactions will most likely occur on a quarterly basis. Based on the Investment Officer's decision, participants may buy, reinvest or sell units on the first business day of each month. All participant buys, reinvestments or sells occur after distribution of accumulated income.

### Investment Income and Distribution

The Statement of Investment Income and Distribution reports cash dividends, interest, net realized gains and losses, and miscellaneous income. MPEP dividends are recorded on the ex-dividend date. For fiscal year 2005, the net realized gains totaled zero as compared to the fiscal year 2004 net realized gains of \$76.6 million. This difference is attributed to a policy change. Effective July 1, 2004, the MPEP net realized gains and losses were retained in the pool rather than distributed to the MPEP participants. This policy change also affected an increase in the Unit Value from \$99.26 as of June 30, 2004 to \$116.06 as of June 30, 2005. The fiscal year 2005 Investment Income reflects only the distribution of ordinary income. The fiscal year 2004 Investment Income includes the distribution of both ordinary income and net realized gains.

The MPEP Income Available for Distribution is distributed or reinvested, on behalf of the nine retirement fund participants as determined by the Investment Officer. Any cash distributions or reinvestments will occur on the first business day of the following month. The Income Available for Distribution is net of MPEP external manager fees and Board administrative expenses.

The fiscal year 2005 administrative expense of \$3,734,605 represents fees paid to the external managers of \$3,498,261 per their contracts and \$236,344 paid to the Board of Investments. The Board of Investments fee includes costs for the custodial bank contract. Administrative expenses incurred by the Board are charged daily to MPEP based on the Board's expenses applicable to MPEP.

The fiscal year 2004 administrative expense of \$2,681,882 represents fees paid to the external managers of \$2,485,166 per their contracts and \$196,716 paid to the Board of Investments. The Board of Investments fee includes costs for the custodial bank contract. Administrative expenses incurred by the Board are charged daily to MPEP based on the Board's expenses applicable to MPEP.

The fiscal year 2005 other expenses represent interest paid in subscribing to a new partnership.

### Security Lending

Because there is no active security lending market for this asset class, MPEP does not participate in security lending.

## **3. COMMITMENTS**

Private equity investments, typically, represent a seven to ten year commitment characterized by capital calls occurring during the first five years with distributions to the investor over the remaining term of the investment. The original and remaining commitments and their respective carrying and fair values, as of June 30, 2005, are listed on the next page.

<u>Security Investment</u>	<u>Original Commitment Date</u>	<u>Original Commitment</u>	<u>Commitment Remaining</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Separate Account Partnerships	Jan 1988-Apr 1990	\$ 14,000,000	\$ 25,000	\$ 2,320,515	\$ 871,970
Venture Partnership Acquisition Fund II	April 1990	4,000,000	0	190,080	48,756
Brinson Venture Capital/Partners Fund III	March 1992	10,000,000	0	2,783,546	1,984,407
Brinson Venture Capital/Partners Fund III	October 1999	10,000,000	0	3,264,253	1,984,817
Brinson Venture Capital Fund IV	May 1999	15,000,000	891,667	12,844,288	9,174,546
Brinson Non-US Partnership Trust	January 1999	10,000,000	3,430,211	5,470,927	6,606,763
Brinson Partnership Trust 1996-2003	March 1996	103,940,867	30,928,433	61,044,091	57,048,755
Adams Street Non-US Partnership Trust	Aug 2001-Dec 2004	16,000,000	12,879,500	2,904,195	3,162,369
Adams Street Partnership Fund	Aug 2001-Dec 2004	94,000,000	75,488,000	17,325,831	17,773,738
Adams Street Partners Fund V	August 2001	40,000,000	24,800,000	15,200,000	13,289,360
Adams Street Global Opportunities	September 2003	25,000,000	23,687,500	1,018,781	1,456,433
Adams Street Total		341,940,867	172,130,311	124,366,507	113,401,916
ArcLight Energy Partners Fund II	April 2004	25,000,000	19,929,911	4,202,766	4,712,780
ArcLight Total		25,000,000	19,929,911	4,202,766	4,712,780
Carlyle Partners Fund IV	January 2005	35,000,000	34,643,001	7,000	7,000
Carlyle Total		35,000,000	34,643,001	7,000	7,000
Inter Mountain Private Equity Partners LP	October 2004	25,000,000	25,000,000	83,333	83,333
Inter Mountain Private Equity Total *		25,000,000	25,000,000	83,333	83,333
KKR 1986, 1987 Fund	August 1987	25,300,000	0	2,021,493	1,803,590
KKR 1993 Fund	December 1990	25,000,000	0	1,285,300	698,882
KKR 1996 Fund	July 1996	100,000,000	0	38,720,252	40,821,058
KKR European Fund	August 1999	25,000,000	3,866,346	16,260,936	18,864,832
KKR Total		175,300,000	3,866,346	58,287,981	62,188,362
Lexington Capital Partners Fund V	May 2001	50,000,000	14,947,423	21,520,090	32,388,833
Lexington Capital Partners Total		50,000,000	14,947,423	21,520,090	32,388,833
Madison Dearborn Partners Fund IV	January 2001	22,509,475	9,061,566	7,792,944	7,366,529
Madison Dearborn Global Fund IV	September 2002	2,490,525	0	3,550,648	4,203,432
Madison Dearborn Total		25,000,000	9,061,566	11,343,592	11,569,961
Oaktree Capital Fund IVB	September 2002	75,000,000	0	1	16,896,984
Oaktree Total		75,000,000	0	1	16,896,984
Odyssey Investment Partners Fund III	December 2004	25,000,000	20,149,852	4,464,155	4,127,031
Odyssey Total		25,000,000	20,149,852	4,464,155	4,127,031
Welsh Carson Anderson & Stowe Fund IX	September 2000	25,000,000	4,250,000	12,954,898	16,634,646
WCAS Capital Partners Fund IV	June 2004	25,000,000	22,000,000	3,000,000	3,000,000
Welsh Carson Total		50,000,000	26,250,000	15,954,898	19,634,646
Total Private Equity Commitments		\$ 827,240,867	\$ 325,978,410	\$ 240,230,324	\$ 265,010,847

\* Commitment contingent upon Intermountain Private Equity Partners raising an additional \$15 million capital.

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all MPEP investments were recorded in the name of the Montana Board of Investments. The State Street Bank repurchase agreement for \$447,174, as of June 30, 2005, was purchased in the State of Montana Board of Investments name. This repurchase agreement was collateralized at \$458,263 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

##### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. Several MPEP investments represent limited partnership investments in various foreign countries. Per GASB Statement No. 40, no foreign currency risk disclosure is required for these limited partnership investments.

As provided for in the partnership agreements, currency exposures may be hedged, partially or fully, at the discretion of the manager to preserve the US dollar value of investments made. Currency speculation, such as over-hedging, reverse hedging or other trading activity not specifically aimed at preserving the US dollar value of investments is not authorized.

## Specific Risk

Private equity investments are recognized as investments with a higher degree of risk with a higher return potential than traditional equity investments. Portfolio diversification of risk is achieved through multiple partnership relationships and investments diversified by time, financing stage, industry sector, investment size and geographical region. Private equity investments typically have a low correlation relative to other investment asset classes and contribute to the reduction of portfolio risk and the enhancement of expected returns on a total investment portfolio basis. Specific risks associated with MPEP are further described in the MPEP Investment Policy Statement.

### **5. NOTICE OF LIABILITY**

The Montana Board of Investments is a limited partner in the private equity partnership of O'Donnell & Masur L.P. O'Donnell & Masur L.P. invested in Gardiner Communications, Inc. All partners of O'Donnell & Masur L.P. received a Notice of Liability from the Internal Revenue Service claiming unpaid federal corporate taxes for Gardiner Communications, Inc. As a recipient of the distributions on the sale and dissolution of Gardiner Communications, Inc., the Board faced potential liability. O'Donnell & Masur L.P. retained legal counsel to represent all partners receiving a Notice of Liability. On September 5, 2003, legal counsel filed a petition on the Montana Board of Investment's behalf in U.S. Tax Court to perfect the Board's right to contest this matter. On February 9, 2004, all partners of O'Donnell & Masur L.P. were informed that the Internal Revenue Service Appeals Officer had completed his review of the Gardiner Communications, Inc. matter. The Officer concluded "no additional taxes are due from Gardiner Communications, Inc. and thus, no transferee liability to the partners of O'Donnell & Masur, L.P."

### **6. PRIVATE EQUITY COMMITMENT**

In August 2005, the staff committed \$25 million to Oak Hill Capital Partnership Fund II (OHCP II), a buyout fund focused on middle-markets companies located in the United States and Canada. On August 24, 2005, the Board made the initial investment of \$2,979,762 which included investment, interest, and related fees.

### **7. CLASS ACTION LITIGATION**

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

### **8. YEAR END PORTFOLIO**

The June 30, 2005 MPEP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

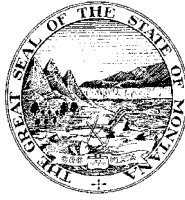
<u>Security Name</u>	<u>Par</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
ALTA SUB DEBT PARTNERS III	74,258	74,258	75,694	0.03%
AUSTIN VENTURES III	235,584	235,584	209,925	0.07%
CAPITAL PARTNERS HOLDINGS II A	9,599	9,599	241,023	0.08%
GATEWAY VENTURE PARTNERS III	263,454	263,454	1,408	0.00%
INTERWEST PARTNERS IV	275,177	275,177	2,795	0.00%
MATRIX PARTNERS III L P	68,064	68,064	15,577	0.01%
NEW ENTERPRISE ASSOC V LP	253,338	253,338	51,154	0.02%
O DONNELL + MASUR L P	352,319	352,319	175,164	0.06%
SPROUT CAPITAL VI	244,756	244,756	362	0.00%
SUMMIT VENTURE II	128,881	128,881	1,644	0.00%
WCAS CAPITAL PARTNERS II	261,611	261,611	96,984	0.03%



<u>Security Name</u>	<u>Par</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>%</u>
WILLIAM BLAIR PARTNERS III LP	153,476	153,476	240	0.00%
<b>SEPARATE PARTNERSHIPS</b>	<b>2,320,515</b>	<b>2,320,515</b>	<b>871,970</b>	<b>0.29%</b>
VENTURE PARTNERSHIP ACQUIST	190,080	190,080	48,756	0.02%
<b>VENTURE PARTNER ACQUISITION II</b>	<b>190,080</b>	<b>190,080</b>	<b>48,756</b>	<b>0.02%</b>
BRINSON VENTURE CAPITAL III SECONDARY	635,144	635,144	391,811	0.13%
BRINSON VENTURE PARTNERS III SECONDARY	2,629,109	2,629,109	1,593,006	0.54%
BRINSON VENTURE CAPITAL FUND III	555,556	555,556	391,811	0.13%
BRINSON VENTURE PARTNER FUND III	2,227,990	2,227,990	1,592,596	0.54%
<b>INSTITUTIONAL VENTURE CAP FUND III</b>	<b>6,047,799</b>	<b>6,047,799</b>	<b>3,969,225</b>	<b>1.33%</b>
BRINSON VENTURE CAPITAL FUND IV	12,844,288	12,844,288	9,174,546	3.08%
<b>BRINSON VENTURE CAPITAL FUND IV</b>	<b>12,844,288</b>	<b>12,844,288</b>	<b>9,174,546</b>	<b>3.08%</b>
BRINSON NON US PARTNERSHIP FUND	5,470,927	5,470,927	6,606,763	2.22%
BRINSON PARTNERSHIP FUND TRUST	61,044,091	61,044,091	57,048,755	19.17%
<b>BRINSON PARTNERSHIP TRUST</b>	<b>66,515,018</b>	<b>66,515,018</b>	<b>63,655,518</b>	<b>21.39%</b>
ADAMS NON US PARTNERSHIP FUND	2,904,195	2,904,195	3,162,369	1.06%
ADAMS STREET PARTNERSHIP FUND	17,325,831	17,325,831	17,773,738	5.97%
<b>ADAMS STREET PARTNERS TRUST</b>	<b>20,230,026</b>	<b>20,230,026</b>	<b>20,936,108</b>	<b>7.03%</b>
ADAMS STREET FUND V	15,200,000	15,200,000	13,289,360	4.46%
<b>ADAMS STREET FUND V</b>	<b>15,200,000</b>	<b>15,200,000</b>	<b>13,289,360</b>	<b>4.46%</b>
ADAMS STREET GLOBAL OPPORTUNITES	1,018,781	1,018,781	1,456,433	0.49%
<b>ADAMS STREET GLOBAL OPPORTUNITES</b>	<b>1,018,781</b>	<b>1,018,781</b>	<b>1,456,433</b>	<b>0.49%</b>
<b>ADAMS STREET TOTAL</b>	<b>124,366,507</b>	<b>124,366,507</b>	<b>113,401,916</b>	<b>38.10%</b>
ARCLIGHT ENERGY PARTNERS FD II	4,202,766	4,202,766	4,712,780	1.58%
<b>ARCLIGHT CAPITAL TOTAL</b>	<b>4,202,766</b>	<b>4,202,766</b>	<b>4,712,780</b>	<b>1.58%</b>
CARLYLE PARTNERS IV, L.P.	7,000	7,000	7,000	0.00%
<b>CARLYLE TOTAL</b>	<b>7,000</b>	<b>7,000</b>	<b>7,000</b>	<b>0.00%</b>
INTER MOUNTAIN PRIVATE EQUITY PARTNERS TOTAL	83,333	83,333	83,333	0.03%
<b>INTER MOUNTAIN TOTAL</b>	<b>83,333</b>	<b>83,333</b>	<b>83,333</b>	<b>0.03%</b>
KKR 1986 1987	2,021,493	2,021,493	1,803,590	0.61%
KKR 1993	1,285,300	1,285,300	698,882	0.23%
KKR 1996	38,720,252	38,720,252	40,821,058	13.71%
KKR EUROPEAN FUND	16,260,936	16,260,936	18,864,832	6.34%
<b>KKR TOTAL</b>	<b>58,287,981</b>	<b>58,287,981</b>	<b>62,188,362</b>	<b>20.89%</b>
LEXINGTON CAPITAL PARTNERSHIP V LP	21,520,090	21,520,090	32,388,833	10.88%
<b>LEXINGTON CAPITAL TOTAL</b>	<b>21,520,090</b>	<b>21,520,090</b>	<b>32,388,833</b>	<b>10.88%</b>
MADISON DEARBORN CAPITAL PARTNERS IV	7,792,944	7,792,944	7,366,529	2.47%
MDP IV GLOBAL INVESTMENTS LP	3,550,648	3,550,648	4,203,432	1.41%
<b>MADISON DEARBORN TOTAL</b>	<b>11,343,592</b>	<b>11,343,592</b>	<b>11,569,961</b>	<b>3.89%</b>
OCM OPPORTUNITIES FUND IVB LP	1	1	16,896,984	5.68%
<b>OAKTREE CAPITAL TOTAL</b>	<b>1</b>	<b>1</b>	<b>16,896,984</b>	<b>5.68%</b>
ODYSSEY INVESTMENT PARTNERS FUND III	4,464,155	4,464,155	4,127,031	1.39%
<b>ODYSSEY PARTNERS TOTAL</b>	<b>4,464,155</b>	<b>4,464,155</b>	<b>4,127,031</b>	<b>1.39%</b>
WCAS CAPITAL PARTNERS FUND IV	3,000,000	3,000,000	3,000,000	1.01%
WCAS IX	12,954,898	12,954,898	16,634,646	5.59%
<b>WCAS TOTAL</b>	<b>15,954,898</b>	<b>15,954,898</b>	<b>19,634,646</b>	<b>6.60%</b>
<b>TOTAL PRIVATE EQUITIES</b>	<b>240,230,324</b>	<b>240,230,324</b>	<b>265,010,847</b>	<b>89.04%</b>
STATE STREET SPIFF	206,943	32,151,434	32,180,151	10.81%
STATE STREET REPURCHASE AGREEMENT	447,174	447,174	447,174	0.15%
<b>STATE STREET TOTAL</b>	<b>654,117</b>	<b>32,598,608</b>	<b>32,627,325</b>	<b>10.96%</b>
<b>MPEP TOTAL</b>	<b>240,884,441</b>	<b>272,828,932</b>	<b>297,638,172</b>	<b>100.00%</b>

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Investments Managed for the state of Montana Board of Investments, All Other Funds, as of June 30, 2005, and 2004, and the related Statement of Net Investment Income and Statement of Changes in Net Investments Managed for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net investments managed by the Montana Board of Investments, All Other Funds, as of June 30, 2005, and 2004, and its net investment income and changes in its net investments managed for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

**STATE OF MONTANA BOARD OF INVESTMENTS  
ALL OTHER FUNDS FINANCIAL STATEMENTS**

**STATEMENT OF NET INVESTMENTS MANAGED, JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<u>Assets</u>		
Investments managed at fair value (amortized cost of \$1,455,078,161 in 2005 and \$1,324,087,590 in 2004) (Notes 2 and 12)	\$ 1,477,780,667	\$ 1,341,236,868
Security lending cash collateral (Notes 3 and 6)	200,025,086	226,699,848
Interest receivable	14,147,103	13,924,158
Broker receivable for securities sold but not settled (Note 2)	<u>150,249</u>	<u>384,976</u>
<b>Total assets</b>	<b>\$ <u>1,692,103,105</u></b>	<b>\$ <u>1,582,245,850</u></b>
<u>Liabilities</u>		
Unrealized gain (loss)	\$ 22,702,506	\$ 17,149,278
Security lending obligations	200,025,086	226,699,848
Security lending expense payable	468,041	186,928
Broker payable for securities purchased but not settled (Note 2)	7,000,000	0
Accounts payable	<u>10,628</u>	<u>10,287</u>
<b>Total liabilities</b>	<b>\$ <u>230,206,261</u></b>	<b>\$ <u>244,046,341</u></b>
<b>Net investments managed</b>	<b>\$ <u>1,461,896,844</u></b>	<b>\$ <u>1,338,199,509</u></b>

**STATEMENT OF NET INVESTMENT INCOME  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

<u>Income</u>		
Investment income (Note 2)	\$ 67,036,824	\$ 65,361,798
Realized gain on sales (Note 2)	14,582,969	76,319,791
Amortization/accretion	(686,441)	(458,413)
Security lending income	<u>4,905,282</u>	<u>1,593,123</u>
<b>Total income</b>	<b>\$ <u>85,838,634</u></b>	<b>\$ <u>142,816,299</u></b>
<u>Expenses</u>		
Administrative expenses	1,041,912	1,303,746
Security lending expense	<u>4,707,900</u>	<u>1,410,223</u>
<b>Total expenses</b>	<b>\$ <u>5,749,812</u></b>	<b>\$ <u>2,713,969</u></b>
<b>Net investment income</b>	<b>\$ <u><del>80,088,822</del></u></b>	<b>\$ <u>140,102,330</u></b>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS  
ALL OTHER FUNDS FINANCIAL STATEMENTS**

**STATEMENT OF CHANGES IN NET INVESTMENTS MANAGED  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
Total net investments managed, beginning of year	\$ 1,338,199,509	\$ 1,372,637,201
Net investment income	80,088,822	140,102,330
Income remitted to agencies	<u>80,311,768</u>	<u>141,104,587</u>
Increase (decrease) in interest receivable	222,946	1,002,257
Increase (decrease) in broker receivable (Note 2)	(234,728)	(891,995)
Increase (decrease) in security lending cash collateral (Notes 3 and 6)	(26,674,762)	170,056,448
Investments purchased	2,935,049,627	1,172,224,997
Investments sold, matured and called (Note 10)	<u>(2,803,372,615)</u>	<u>(1,207,786,541)</u>
Increase (decrease) in book value of investments	131,677,012	(35,561,544)
Increase (decrease) in book value of investments due to net amortization of discounts and premiums	(686,441)	(458,413)
(Increase) decrease in broker payable (Note 2)	(7,000,000)	1,592,849
(Increase) decrease in accounts payable	(341)	(857)
(Increase) decrease in security lending obligations (Notes 3 and 6)	26,674,762	(170,056,448)
(Increase) decrease in security lending expense payable	<u>(281,113)</u>	<u>(119,989)</u>
Net investments managed, end of year	\$ <u>1,461,896,844</u>	\$ <u>1,338,199,509</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
ALL OTHER FUNDS  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004

**1. HISTORY AND ORGANIZATION**

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis per section 17-6-201, MCA. The All Other Funds (AOF) investments and income are owned by various State of Montana agencies and managed on their behalf by the Board.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Investments**

The AOF investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle" and applicable investment restrictions of the participants. The AOF portfolio includes securities classified as corporate, U.S. government direct-backed, U.S. government indirect-backed, equity index, real estate, mortgages and loans. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages. Equity index investments are investments in selected mutual funds whose equity portfolios match a broad based index or composite.

AOF fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. As of June 30, 2005, the AOF portfolio held one variable rate corporate bond with an amortized cost of \$4 million. As of June 30, 2004, the AOF portfolio held one variable-rate security, with an amortized cost of \$15,585,949 reported as a government mortgage-backed security. This security paid off in March 2005. The AOF variable-rate securities float with LIBOR (London Interbank Offered Rate) or the weighted average of the net mortgage interest rates for the mortgage loan group. (See Note 12 for the Year End Portfolio.)

Investments are presented in the Statement of Net Investments Managed at fair value. Fair values for publicly traded securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank and Trust. The real estate investments and residential and multi-family mortgages are valued based on a discounted cash flow. The commercial in-state coal tax loans and the nonparticipating repurchase agreements are reported at amortized cost. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

**Broker Receivable/Payable**

All Other Funds security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the AOF portfolio at June 30 may include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

**Montana Mortgages and Loans Receivable**

The Montana mortgages and loans receivable, included in the Net Investments Managed at Fair Value, represent residential mortgages and multifamily commercial loans funded by the Public Employees' and Teachers' pension funds and other loans funded by the Coal Severance Tax Trust fund. In November and December 2004, the multifamily commercial loans held by the Public Employees' and Teachers' pension funds totaling \$3,334,969 were sold to the Coal Severance Tax Trust Fund. The Coal Severance Tax Trust loan portfolio includes loans made by the Montana Science and Technology Alliance (MSTA) Board. The MSTTA Board was abolished on July 1, 1999 and by law, the MSTTA portfolio was assigned to the Board of Investments. (See Note 7 for the Montana mortgages and loans portfolio).

In June 2005, the Board received notice that Positive Systems, Inc. has "ceased business operations". This borrower, funded by the MSTTA, received \$200,000 and \$350,000 in May 1994 and March 1998, respectively. As of June 30, 2005, Positive Systems, Inc. had an outstanding loan balance of \$546,074. With the exception of this loan, there were no other uncollectible account balances for Montana mortgages and loans receivable as of June 30, 2005. In February 2005, the Board charged off \$147,156 in principal for Safe ShopTools, Inc. The MSTTA funded a total of \$162,500 to Safe ShopTools, Inc. in February 1997 and June 1999. As of June 30, 2004, there were no uncollectible account balances for Montana mortgages and loans receivable.

In March 2005, the Monthly Mortgage Accounting Process related to remittances, payoffs and billing was transferred to the Montana Board of Housing accounting staff.

### Investment Income

Investment income reported in the Statement of Net Investment Income includes fixed income and mortgage interest earnings, real estate income, commercial loan interest earnings and commitment fees. For fiscal year 2004, the decrease in interest income of \$11.9 million is attributed, primarily, to a decrease in the commercial loan and mortgage interest earnings.

### Realized Gain on Sales

Realized gain on sales reported in the Statement of Net Investment Income represents the net gain/loss resulting from the sale of fixed income, private equity and pool investments. In fiscal year 2005, the sale of pool units from the Montana Domestic Equity Pool (MDEP) and the Trust Funds Bond Pool (TFBP), generated a net gain to participants of \$13,609,808. The sale of pool units in fiscal year 2004 from the Montana Domestic Equity Pool (MDEP), Montana Private Equity Pool (MPEP), Retirement Funds Bond Pool (RFBP) and Trust Funds Bond Pool (TFBP) resulted in a net gain to participants of \$73,214,644.

## **3. SECURITIES LENDING**

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2005 and 2004, State Street Bank loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2005 and 2004 on the amount of the loans that State Street Bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2005 and 2004. Moreover, there were no losses during fiscal years 2005 and 2004 resulting from a default of the borrowers or State Street Bank.

During fiscal years 2005 and 2004, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 35 and 49 days, respectively, as of June 30, 2005 and 2004. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2005, the carrying and fair value of the underlying securities on loan for the All Other Funds was \$213,820,105 and \$217,153,315, respectively. The collateral provided for the securities on loan totaled \$200,025,086 in cash and \$23,616,389 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$31,693,857 corporate, \$30,489,301, U.S. government direct-backed and \$151, 636,947 U.S. government indirect-backed.

As of June 30, 2004, the carrying and fair value of the underlying securities on loan for the All Other Funds was \$219,045,397 and \$222,235,651, respectively. The collateral provided for the securities on loan totaled \$228,078,235 representing \$226,699,848 in cash and \$ 1,378,387 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$31,745,041 corporate, and \$187,300,356 U.S. government indirect-backed.

## **4. COAL TAX LOAN AND MORTGAGE COMMITMENTS**

The Board makes firm commitments to fund loans from the Coal Severance Tax Trust fund. These commitments have expiration dates and may be extended according to the Board's policies. As of June 30, 2005, the Board had committed but not yet purchased \$78,813,735 in loans from Montana lenders, compared to \$69,281,764 as of June 30, 2004. In addition to the above commitments, lenders had reserved \$28,884,945 for loans as of June 30, 2005, compared to \$12,021,150 on the same date in 2004.

The Board makes firm commitments to fund mortgages from the Public Employees' and Teachers' retirement funds. As of June 30, 2005 and 2004, the Board had committed but not yet purchased from Montana lenders mortgages totaling \$2,145,343 and \$124,550, respectively. As of June 30, 2005, mortgage reservations totaled \$1,683,900. As of June 30, 2004, lenders had reserved no funding for mortgages.

## 5. PENSION FUND REAL ESTATE INVESTMENTS

### 100 North Park Building

In January 1996, the Board, on behalf of the Public Employees' and Teachers' Retirement funds, purchased the 100 North Park Avenue Building in Helena, Montana as a real estate investment. Acquired for a cost of \$4,864,326, the building carries a fair value of \$6,024,526 as of June 30, 2005. During fiscal year 2005, building improvements for tenant remodeling, video conferencing, heating/cooling, parking lot resurfacing and leasing fees totaling \$151,567 were added to the cost of the building. Building improvements and leasing fees totaling \$453,209 were included in the cost of the building in fiscal year 2004. The three-story building provides office space for approximately eight to ten tenants.

### 2401 Colonial Drive Building

In August 1997, the Board authorized the construction of an office building, as a real estate investment owned equally by the Public Employees' and Teachers' Retirement funds. Construction costs, including interest capitalization, totaled \$6,481,741 as of June 30, 2000. In fiscal year 2005, parking lot resurfacing and heating/cooling system improvements of \$48,838 were added to the building cost. For fiscal year 2004, \$55,287 was expended on building landscaping, leasing fees, lighting and construction. The three-story building, providing office space for three tenants, was occupied in November 1999. As of June 30, 2005, the building carries a cost and fair value of \$7,090,594 and \$7,581,000, respectively.

### 2273 Boot Hill Court Building

In August 1999, the Board authorized the purchase of a new office building in Bozeman, Montana. Upon construction completion, the Public Employees' and Teachers' Retirement funds purchased the building, in March 2004, as a real estate investment with equal ownership, for \$2,051,032. In fiscal year 2005, telecommunication system payments were added to the building cost of \$10,238. The building, located on state school trust land, is occupied by four state agencies. As of June 30, 2005, the building carries a fair value of \$2,082,014.

### 1712 Ninth Avenue Building

In November 2000, the Board reviewed the transfer of the Public Employees' Retirement Administration (PERA) office building, located at 1712 Ninth Avenue, Helena, to the Board of Investments. By issuance of a corrective deed, the Board of Investments was named owner and building manager for the use and benefit of the PERA. During fiscal years 2005 and 2004, fire alarm system upgrades and parking lot improvements totaling \$12,600 and \$9,525, respectively, were added to the building cost for a year end book value of \$511,312. As of June 30, 2005, the building is valued at \$576,369.

The schedule below details the minimum future rentals for the above buildings with non-cancelable operating leases as of June 30, 2005 and 2004:

#### Minimum future rentals for the year ending June 30, 2005:

<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011+</u>	<u>Total</u>
\$705,654	\$404,495	\$295,823	\$243,861	\$248,731	\$731,656	\$2,630,222

#### Minimum future rentals for the year ending June 30, 2004:

<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Total</u>
\$773,141	\$497,523	\$442,228	\$308,401	\$243,861	\$980,388	\$3,245,543

### California Street Property

In December 1998, the Board acquired a parcel of land adjacent to the Colonial Drive building to provide for additional parking. This land was purchased for \$204,835. As of June 30, 2005 the property carries a fair value of \$210,521.

## 6. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The financial statement disclosures for the year ended June

30, 2004 have been restated to compare with the financial statement disclosures for the year ended June 30, 2005. The investment risk disclosures are described in the following paragraphs.

### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the AOF fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires AOF fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's and/or Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the following table are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, all the fixed income and other equity securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The Equity Index, Real Estate, Mortgage and Loan investments are registered in the name of the Montana Board of Investments. The US Bank Municipal Investors Account, State Street and US Bank repurchase agreements were purchased in the State of Montana Board of Investments name.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. With the exception of one fund, the 19 remaining investment policy statements for various state agencies do not address concentration of credit risk. One fund requires credit risk to be limited to 3 percent in any one name except AAA rated issues will be limited to 6%. Investments issued or explicitly guaranteed by the U.S. government and investments by various state agencies, pooled as the All Other Funds, are excluded from the concentration of credit risk requirement.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The All Other Funds' investment policies do not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs and ARMs)."

As of June 30, 2005, the AOF portfolio did not hold any structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. As of June 30, 2004, the AOF portfolio held a REMIC with an amortized cost of \$15,585,949 as reported in the U.S. government mortgage-backed category. This security paid off in March 2005. The REMIC securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages. When underlying mortgages are prepaid, the interest cash flows are reduced while principal cash flows are increased. If homeowners pay on mortgages longer than anticipated, the cash flow effect would be the opposite.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2005 and June 30, 2004. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).



**Credit Quality Rating and Effective Duration as of June 30, 2005**

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Corporate Bonds (Rated)	\$ 344,153,594	A	3.83
U.S. Government Direct-Backed	72,631,014	AAA	3.35
U.S. Government Indirect-Backed	634,726,860	AAA	2.74
State Street Repurchase Agreement* (Rated)	10,350,520	AA-	NA
US Bank Sweep Repurchase Agreement**	16,542,234	NR	NA
Total Fixed Income Investments	\$ 1,078,404,222	AA	2.99
<u>Direct Investments</u>			
Equity Index Fund	\$ 76,737,097		
Equity Other	140		
Real Estate	16,474,430		
MT Mortgages and Loans	306,164,778		
Total Direct Investments	\$ 399,376,445		
<b>TOTAL INVESTMENTS</b>	<b>\$ 1,477,780,667</b>		
Securities Lending Collateral Investment Pool	\$ 200,025,086	NR	NA

\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at \$10,607,177 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

\*\*At June 30, 2005, the US Bank repurchase agreement, per contract, was collateralized at 102% for \$16,874,485 by Federal Home Loan Mortgage Corporation REMICs maturing September 15, 2032 and November 15, 2033. These securities carry a AAA credit quality rating.

**Credit Quality Rating and Effective Duration as of June 30, 2004**

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Corporate Bonds (Rated)	\$ 346,945,807	A	4.09
U.S. Government Direct-Backed	77,292,383	AAA	4.54
U.S. Government Indirect-Backed	445,288,148	AAA	3.27
US Bank Sweep Repurchase Agreement	0	NA	NA
Municipal Investor Account*	37,847,576	NR	NA
Total Fixed Income Investments	\$ 907,373,914	AA	3.71
<u>Direct Investments</u>			
Equity Index Fund	\$ 72,138,374		
Equity Other	23		
Real Estate	16,242,050		
MT Mortgages and Loans	345,482,507		
Total Direct Investments	\$ 433,862,954		
<b>TOTAL INVESTMENTS</b>	<b>\$ 1,341,236,868</b>		
Securities Lending Collateral Investment Pool	\$ 226,699,848	NR	NA

\*At June 30, 2004, the Municipal Investor Account was collateralized at \$188,679,916 by AAA rated FNMA FNCL pools maturing on April 1, and May 1, 2033. This account, covered by \$100,000 from the FDIC (Federal Deposit Insurance Corporation), was closed February 28, 2005.

## Specific Legal and Credit Risk

As of June 30, 2005, Delta Airlines Corp. presented a higher credit risk to the Board. The AOF portfolio holds \$10 million par 6.417% Delta Airlines Corp. bond maturing July 2, 2012. The book value of this security was \$9,968,673 as of June 30, 2005. This issue is insured by MBIA Insurance Corp to support the payment of any interest due and outstanding principal balance. The company filed for Chapter 11 bankruptcy protection on September 14, 2005. Since this issue is insured, the Board did not stop interest income accrual or reduce the book value.

As of June 30, 2005, Northwest Airlines Inc. presented a higher credit risk to the Board. The AOF portfolio held a \$4,137,515 par 6.81% Northwest Airlines Inc. bond maturing February 1, 2020. The book value of this security was \$4,084,548 as of June 30, 2005. Due to the company's filing for Chapter 11 bankruptcy protection on September 14, 2005, the Board stopped the interest income accruals after the August 2005 pay date. This issue was sold on September 20, 2005 generating a loss of \$358,311. The sale included accrued interest from August 1, 2005 to September 20, 2005.

## 7. MONTANA MORTGAGES AND LOANS

The Montana mortgages and loans portfolio is shown below.

<u>Montana Mortgages and Loans</u>	<u>2005 Book Value</u>	<u>2004 Book Value</u>
<b>Multifamily Commercial Loans</b>	<b>\$ 0</b>	<b>\$ 4,105,800</b>
<b>Residential Mortgages</b>	<b>92,939,453</b>	<b>119,513,572</b>
Science and Technology Alliance <sup>(1)</sup>	5,046,515	13,959,035
Department of Natural Resources <sup>(2)</sup>	41,896,024	44,546,088
Department of Justice	2,112,000	2,037,000
Montana Facility Finance	47,482	943,904
Local Government Infrastructure	5,659,452	8,298,805
Value-added Loans	11,104,002	9,202,821
Department of Revenue <sup>(3)</sup>	0	5,698,442
Commercial Loans	146,488,105	137,175,547
<b>Permanent Coal Trust Loans</b>	<b>212,353,581</b>	<b>221,861,642</b>
<b>Total Montana Mortgages and Loans</b>	<b>\$ 305,293,033</b>	<b>\$ 345,481,014</b>

(1) The Montana Science and Technology Alliance (MSTA) loans include funding for research and development, mezzanine and seed capital loans.

(2) In accordance with Senate Bill 495 enacted by the 2001 Legislature, the Coal Severance Tax Permanent Trust loaned 483,604 TFBP shares, with a book value of \$46,366,904, to the Department of Natural Resources, Trust and Legacy fund on July 2, 2001. The loan proceeds were deposited in the Trust and Legacy Fund. A loan receivable was recorded in the Coal Severance Tax Permanent Trust and a corresponding liability was recorded in the Guarantee Fund, a General Fund sub-fund. The August 2002 Special Legislative Session approved the request to record this activity in a state special revenue fund of the Office of Public Instruction rather than in the Guarantee Fund. On June 30, 2004, the Trust and Legacy Fund paid \$1,820,816 to the Coal Severance Tax Permanent Trust reducing the TFBP shares on loan to 464,613 with a corresponding book value of \$44,546,088. During fiscal year 2005, the Trust and Legacy Fund paid \$2,650,063 to the Coal Severance Tax Permanent Trust reducing the TFBP shares on loan to 436,973 with a corresponding book value of \$41,896,024.

(3) On August 26, 2004, the Board voted to increase the Department of Revenue loan commitment to \$17 million. This loan provides funding for the Department of Revenue's POINTS Computer System replacement project, IRIS. The balance as of July 1, 2004 was \$5,698,442. During fiscal year 2005, the Board authorized \$8,738,505 in fundings and received principal payments of \$14,436,947. On June 15, 2005, the IRIS loan was paid off.

## 8. DEUTSCHE BANK SECURITIES, INC. COMPLAINT

The Board received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$2 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25, 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$215,453 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and

expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The Board tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of \$113.099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the Board received \$2,273,230 in principal and interest plus \$60,000 as a consent fee. As of September 23, 2005, this matter is still pending.

## 9. LOAN GUARANTEES

As of June 30, 2005, loan guarantees provided by the Coal Severance Tax Permanent Trust to the Enterprise Fund and the Montana Facility Finance Authority total \$130,476,641. Board of Investment exposure to bond issues of the Enterprise Fund is \$85,160,000 while exposure to bond issues, surety bonds and designated loans of the Facility Finance Authority is \$45,316,641.

As of June 30, 2004, loan guarantees provided by the Coal Severance Tax Permanent Trust to the Enterprise Fund and the Montana Facility Finance Authority, totaled \$126,787,072. Board of Investment exposure to bond issues of the Enterprise Fund was \$92,052,796 while exposure to bond issues, surety bonds and designated loans of the Facility Finance Authority was \$34,734,276.

## 10. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

The trading system will serve the Board's internally managed portfolios and will be phased in as training is completed. Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Electronic trading for the Short Term Investment Pool will be next followed by the other fixed income portfolios managed by Board Staff.

## 11. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 12. YEAR END PORTFOLIO

The June 30, 2005 All Other Funds portfolio is listed below. The security type percentage is based on the fair value ratio of the specific category of securities to the total portfolio.

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>% of Total</u>
STATE STREET REPURCHASE AGREEMENT	2.250	07/01/05	10,350,520	10,350,520	10,350,520	0.70%
US BANK SWEEP REPURCHASE AGREEMENT	3.000	07/01/05	16,542,234	16,542,234	16,542,234	1.12%
<b>CASH EQUIVALENTS</b>			<b>26,892,754</b>	<b>26,892,754</b>	<b>26,892,754</b>	<b>1.82%</b>
AA / FT WORTH HQ FINANCE TRUST	5.500	10/05/10	10,462,276	10,462,276	10,180,841	0.69%
<b>ABBOTT LABS</b>	<b>3.500</b>	02/17/09	10,000,000	9,961,684	9,806,903	0.66%
AMERICAN AIRLINE EQUIPMENT TRUST	6.977	05/23/21	3,569,221	3,560,360	3,283,684	0.22%
AMERICAN GENERAL FINANCIAL CORP	4.875	05/15/10	5,000,000	4,999,319	5,067,910	0.34%
BANK AMERICA CORP	3.375	02/17/09	5,000,000	4,981,130	4,871,012	0.33%
BANK AMERICA CORP	5.375	06/15/14	5,000,000	4,959,012	5,300,506	0.36%
BANK ONE CORP	6.250	02/15/08	2,000,000	1,957,100	2,100,385	0.14%
BANKBOSTON NA	6.375	03/25/08	2,000,000	1,958,987	2,114,432	0.14%

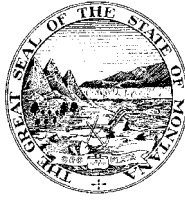
Security Name	Coupon	Maturity	Par	Book Value	Fair Value	% of Total
BORG WARNER AUTOMOTIVE INC	7.000	11/01/06	4,000,000	4,019,972	4,143,746	0.28%
BURLINGTON NORTHERN RR CO EQUIPMENT TRUST	6.940	01/02/14	3,194,089	3,194,089	3,727,671	0.25%
BURLINGTON NORTHERN SANTA FE EQUIPMENT TR	7.160	01/02/20	4,373,523	4,373,523	5,019,213	0.34%
CIT GROUP EQUIPMENT TRUST	6.490	01/05/21	7,337,858	7,337,858	8,115,599	0.55%
CIT GROUP INC	5.750	09/25/07	5,000,000	5,095,475	5,161,228	0.35%
CSX CORP	7.450	05/01/07	5,000,000	4,998,615	5,292,266	0.36%
CENTEX CORP	5.700	05/15/14	3,000,000	2,996,337	3,116,422	0.21%
CITIGROUP INC	5.750	05/10/06	1,000,000	999,985	1,017,547	0.07%
CITIGROUP INC	6.000	02/21/12	5,000,000	4,998,771	5,464,327	0.37%
CITIGROUP INC	3.625	02/09/09	5,000,000	4,991,337	4,908,479	0.33%
CONTINENTAL AIRLINES EQUIPMENT TRUST	6.563	08/15/13	5,000,000	5,018,716	5,313,981	0.36%
COUNTRYWIDE HOME LOANS INC	2.875	02/15/07	8,000,000	7,993,952	7,837,391	0.53%
COX COMMUNICATIONS INC	4.625	01/15/10	3,000,000	2,997,213	2,992,080	0.20%
DELTA AIR LINES INC EQUIPMENT TRUST	6.417	07/02/12	10,000,000	9,968,673	10,520,492	0.71%
DETROIT EDISON CO	5.200	10/15/12	5,000,000	4,949,489	5,199,202	0.35%
DONNELLEY R R + SONS CO	4.950	04/01/14	5,000,000	4,817,234	4,877,215	0.33%
ENTERGY ARKANSAS INC	4.500	06/01/10	3,000,000	2,986,942	3,000,587	0.20%
FIRST CHICAGO CORP	6.375	01/30/09	2,000,000	1,930,917	2,143,322	0.15%
FIRST UNION CORP	7.050	08/01/05	5,000,000	4,999,488	5,016,157	0.34%
FORD MOTOR CREDIT	5.800	01/12/09	5,000,000	5,062,588	4,748,047	0.32%
FORD MOTOR CREDIT	5.700	01/15/10	5,000,000	4,969,557	4,603,674	0.31%
GALENA CDO TRUST	VAR	01/11/13	4,000,000	4,000,000	4,000,000	0.27%
GENERAL ELECTRIC CAPITAL CORP	4.375	11/21/11	2,000,000	1,996,710	1,995,187	0.14%
GENERAL ELECTRIC CAPITAL CORP	5.375	03/15/07	10,000,000	10,108,747	10,233,472	0.69%
GENERAL MOTORS ACCEPTANCE CORP	7.500	07/15/05	9,000,000	8,999,934	9,008,121	0.61%
GENERAL MOTORS ACCEPTANCE CORP	6.125	08/28/07	5,000,000	5,003,953	4,937,581	0.33%
GENERAL MOTORS ACCEPTANCE CORP	5.625	05/15/09	7,000,000	7,042,033	6,504,649	0.44%
GOLDMAN SACHS GROUP INC	3.875	01/15/09	5,000,000	5,040,135	4,928,119	0.33%
HOUSEHOLD FINANCE CORP	6.875	03/01/07	3,000,000	2,982,578	3,136,930	0.21%
HOUSEHOLD FINANCE CORP	4.750	05/15/09	1,000,000	999,330	1,015,617	0.07%
IBP FINANCIAL CO	7.450	06/01/07	4,000,000	3,999,471	4,166,280	0.28%
ING SECURITY LIFE INSTITUTIONAL FUND	4.250	01/15/10	3,000,000	2,994,041	2,991,864	0.20%
INTERNATIONAL LEASE FINANCE CORP	4.550	10/15/09	5,000,000	5,112,117	5,046,075	0.34%
J P MORGAN CHASE + CO	5.350	03/01/07	5,000,000	4,991,653	5,110,239	0.35%
J P MORGAN CHASE + CO	3.500	03/15/09	10,000,000	9,955,983	9,736,730	0.66%
J P MORGAN CHASE COMMERCIAL MORTGAGE TRT	4.200	07/12/35	20,545,739	20,640,358	20,474,832	1.39%
J P MORGAN CHASE COMMERCIAL MORTGAGE TRT	3.053	01/15/38	2,672,372	2,680,027	2,600,771	0.18%
KCT INTERMODAL EQUIPMENT TRUST	6.884	08/01/18	3,472,533	3,472,533	3,851,325	0.26%
KEY BANK	4.412	03/18/08	5,000,000	5,000,000	5,021,160	0.34%
KRAFT FOODS INC	4.125	11/12/09	3,000,000	2,987,238	2,974,542	0.20%
LEHMAN BROTHERS HOLDINGS INC	3.950	11/10/09	3,000,000	2,994,785	2,958,429	0.20%
MARSH + MCLENNAN COS INC	7.125	06/15/09	3,000,000	2,997,057	3,245,560	0.22%
MERRILL LYNCH + CO INC	4.125	01/15/09	5,000,000	4,997,923	4,978,323	0.34%
METLIFE INC	5.000	11/24/13	5,000,000	4,959,645	5,086,030	0.34%
MORGAN STANLEY	4.000	01/15/10	5,000,000	4,963,572	4,915,081	0.33%
NATIONWIDE FINANCIAL SERVICES INC	6.250	11/15/11	5,000,000	5,261,827	5,446,327	0.37%
NORTHWEST AIRLINES EQUIPMENT TRUST	6.810	02/01/20	4,137,515	4,084,548	3,573,779	0.24%
OLD REPUBLIC INTERNATIONAL CORP	7.000	06/15/07	3,000,000	2,999,683	3,159,126	0.21%
PNC FUNDING CORP	4.200	03/10/08	5,000,000	4,997,892	5,001,510	0.34%
PPL MONTANA LLC	8.903	07/02/20	4,112,337	4,112,337	4,926,167	0.33%
PANAMERICAN BEVERAGES INC	7.250	07/01/09	2,000,000	1,975,727	2,180,359	0.15%
ALTRIA GROUP INC	7.650	07/01/08	5,000,000	5,365,479	5,420,418	0.37%
PRINCIPAL LIFE GLOBAL FUNDING	5.125	10/15/13	5,000,000	4,993,908	5,153,799	0.35%
SWTHTSWEST GAS CORP	8.375	02/15/11	4,000,000	3,996,563	4,685,173	0.32%
UNION PACIFIC CORP	6.400	02/01/06	5,000,000	4,997,711	5,080,689	0.34%
UNION TANK CAR CO	7.125	02/01/07	2,000,000	1,999,661	2,091,435	0.14%
WACHOVIA CORP	4.950	11/01/06	3,000,000	2,998,243	3,044,399	0.21%
WASHINGTON MUTUAL INC	4.200	01/15/10	5,000,000	4,993,147	4,960,040	0.34%
WELLS FARGO + CO	5.900	05/21/06	1,000,000	999,781	1,019,382	0.07%
WELLS FARGO + CO	4.625	04/15/14	5,000,000	4,810,795	5,035,799	0.34%
WESTERN PROPERTIES REIT	7.200	09/15/08	1,000,000	981,031	1,081,054	0.07%
WYETH	5.500	02/01/14	5,000,000	4,991,691	5,256,112	0.36%
ZIONS BANCORPORATION	5.650	05/15/14	3,000,000	2,996,545	3,176,796	0.21%
Corporate Bonds (Rated)			337,877,465	338,016,993	344,153,594	23.29%

Security Name	Coupon	Maturity	Par	Book Value	Fair Value	% of Total
ENSCO OFFSHORE CO XI USGG	6.360	12/01/15	10,500,237	10,500,237	11,474,554	0.78%
GLOBAL INDUSTRIES LTD XI USGG	7.710	02/15/25	4,000,000	4,000,000	4,000,000	0.27%
MAYBANK NAVIGATION LLC XI USGG	7.620	07/25/20	3,875,000	3,875,000	4,096,224	0.28%
NORTH AMERICAN SHIP BUILDING XI USGG	5.840	02/15/06	644,000	644,000	644,000	0.04%
ROWAN COS INC XI USGG	5.880	03/15/12	15,907,000	15,907,000	16,633,473	1.13%
TRICO MARINE INTERNATIONAL XI USGG	6.080	09/01/06	1,875,000	1,875,000	1,875,000	0.13%
MAY BANK NAVIGATION CO LLC XI USGG	5.900	09/16/13	2,258,000	2,258,000	2,258,000	0.15%
UNITED STATES TREASURY NOTES	3.000	02/15/09	2,000,000	1,946,203	1,953,282	0.13%
UNITED STATES TREASURY NOTES	2.500	09/30/06	10,000,000	9,895,865	9,867,188	0.67%
UNITED STATES TREASURY NOTES	3.000	12/31/06	10,000,000	9,965,678	9,908,200	0.67%
UNITED STATES TREASURY NOTES	3.125	01/31/07	10,000,000	9,958,128	9,921,094	0.67%
<b>U.S. Government Direct-Backed</b>			<b>71,059,237</b>	<b>70,825,112</b>	<b>72,631,014</b>	<b>4.91%</b>
FEDERAL HOME LOAN MORTGAGE CORP	4.750	10/11/12	20,000,000	19,948,658	20,026,502	1.36%
FEDERAL HOME LOAN MORTGAGE CORP	5.125	05/13/13	20,000,000	20,000,000	19,899,992	1.35%
FEDERAL HOME LOAN MORTGAGE CORP	4.000	07/18/18	5,000,000	5,000,000	4,898,311	0.33%
FEDERAL HOME LOAN MORTGAGE CORP	3.050	01/19/07	10,000,000	9,890,715	9,872,595	0.67%
FEDERAL HOME LOAN MORTGAGE CORP	4.100	01/28/14	15,000,000	15,000,000	14,961,885	1.01%
FEDERAL HOME LOAN MORTGAGE CORP	2.850	02/23/07	20,000,000	19,984,291	19,664,186	1.33%
FEDERAL HOME LOAN MORTGAGE CORP	3.625	02/15/07	10,000,000	9,979,557	9,955,714	0.67%
FEDERAL HOME LOAN MORTGAGE CORP	4.050	06/28/07	15,000,000	15,000,000	14,990,187	1.01%
FEDERAL HOME LOAN PC POOL E00247	5.500	10/01/08	199,352	197,773	204,764	0.01%
FEDERAL HOME LOAN PC POOL E00540	6.000	03/01/13	1,656,272	1,652,171	1,715,212	0.12%
FEDERAL HOME LOAN PC POOL E00659	6.000	04/01/14	1,720,819	1,719,745	1,782,056	0.12%
FEDERAL HOME LOAN PC POOL G10814	5.500	05/01/13	2,605,431	2,603,895	2,682,678	0.18%
FEDERAL HOME LOAN PC POOL G10173	6.000	01/01/09	256,215	255,708	265,172	0.02%
FEDERAL AGRICULTURE MORTGAGE CORP	5.300	04/24/06	20,000,000	20,437,532	20,238,782	1.37%
FEDERAL FARM CREDIT BANKS	3.100	01/22/08	10,000,000	9,783,013	9,792,552	0.66%
FEDERAL HOME LOAN BANKS	4.875	11/15/06	5,000,000	4,980,475	5,068,550	0.34%
FEDERAL HOME LOAN BANKS	4.875	02/15/07	5,000,000	4,999,642	5,078,711	0.34%
FEDERAL HOME LOAN BANKS	3.500	08/15/06	10,000,000	10,127,398	9,958,662	0.67%
FEDERAL HOME LOAN BANKS	2.500	03/15/06	10,000,000	10,015,975	9,913,340	0.67%
FEDERAL HOME LOAN BANKS	2.375	02/15/06	15,000,000	15,001,629	14,873,057	1.01%
FEDERAL HOME LOAN BANKS	2.250	05/15/06	10,000,000	9,990,323	9,865,126	0.67%
FEDERAL HOME LOAN BANKS	4.125	08/13/10	20,000,000	19,981,588	20,041,940	1.36%
FEDERAL HOME LOAN BANKS	3.625	11/14/08	10,000,000	9,984,413	9,916,919	0.67%
FEDERAL HOME LOAN BANKS	2.750	11/15/06	10,000,000	10,034,868	9,846,188	0.67%
FEDERAL HOME LOAN BANKS	3.250	02/26/07	10,000,000	10,001,980	9,909,400	0.67%
FEDERAL HOME LOAN BANKS	3.375	09/14/07	10,000,000	10,054,259	9,907,155	0.67%
FEDERAL HOME LOAN BANKS	3.750	09/29/06	20,000,000	19,947,220	19,961,464	1.35%
FEDERAL HOME LOAN BANKS	3.750	11/30/06	15,000,000	14,993,571	14,965,755	1.01%
FEDERAL HOME LOAN BANKS	4.000	03/30/07	25,000,000	25,000,000	24,958,150	1.69%
FEDERAL HOME LOAN MORTGAGE CORP	5.625	03/15/11	10,000,000	10,053,084	10,784,478	0.73%
FEDERAL HOME LOAN MORTGAGE CORP	6.000	06/15/11	15,000,000	14,992,083	16,504,604	1.12%
FEDERAL HOME LOAN MORTGAGE CORP	3.625	09/15/08	14,000,000	14,046,284	13,884,654	0.94%
FEDERAL HOME LOAN MORTGAGE CORP	2.125	11/15/05	7,000,000	6,999,520	6,961,554	0.47%
FEDERAL HOME LOAN MORTGAGE CORP	2.875	05/15/07	10,000,000	9,971,983	9,833,963	0.67%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.300	05/05/08	10,000,000	10,026,561	9,999,469	0.68%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.000	05/09/07	10,000,000	10,005,603	9,990,838	0.68%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	5.750	02/15/08	5,000,000	5,347,437	5,233,298	0.35%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	6.000	05/15/08	5,000,000	4,937,509	5,284,351	0.36%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	0.010	06/01/17	14,600,000	6,828,639	8,530,955	0.58%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	7.250	01/15/10	8,000,000	8,261,878	9,068,630	0.61%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	6.625	10/15/07	15,000,000	15,636,056	15,903,828	1.08%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	6.625	11/15/10	10,000,000	10,233,653	11,224,583	0.76%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	6.000	12/15/05	2,000,000	2,003,260	2,021,570	0.14%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	5.250	06/15/06	5,000,000	5,010,123	5,066,713	0.34%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.250	11/15/07	10,000,000	9,931,541	9,865,155	0.67%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.375	07/17/13	20,000,000	19,368,241	19,704,888	1.33%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.375	12/15/08	15,000,000	14,904,253	14,735,168	1.00%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.125	04/15/14	10,000,000	9,431,702	9,928,386	0.67%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.010	06/02/06	15,000,000	14,996,764	14,891,045	1.01%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.000	08/15/07	10,000,000	9,958,050	9,827,943	0.67%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.550	11/16/07	10,000,000	10,000,000	9,925,760	0.67%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	5.875	02/14/06	5,000,000	4,982,242	5,065,701	0.34%

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>% of Total</u>
FEDERAL NATIONAL MORTGAGE ASSOCIATION	2.200	12/04/06	20,000,000	19,644,483	19,538,944	1.32%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.310	01/26/07	15,000,000	14,956,131	14,869,223	1.01%
FEDERAL NATIONAL MORTGAGE ASSOCIATION	3.250	05/11/07	15,000,000	14,991,280	14,845,932	1.00%
FNMA POOL 190985	7.500	08/01/09	606,421	606,421	638,258	0.04%
FNMA POOL 254140	5.500	01/01/17	9,231,715	9,199,854	9,493,160	0.64%
FNMA POOL 254233	5.000	03/01/17	6,753,336	6,560,709	6,847,513	0.46%
FNMA POOL 254631	5.000	02/01/18	5,553,711	5,602,747	5,622,478	0.38%
FNMA POOL 303590	7.000	11/01/10	746,665	746,664	783,152	0.05%
FNMA POOL 313999	6.000	02/01/13	914,575	911,107	947,263	0.06%
FNMA POOL 572220	6.000	03/01/16	515,944	514,736	534,062	0.04%
FNMA POOL 592327	5.500	06/01/16	1,121,866	1,100,354	1,154,339	0.08%
<b>U.S. Government Indirect-Backed</b>			<b>637,482,320</b>	<b>629,327,349</b>	<b>634,726,860</b>	<b>42.95%</b>
S&P 500 INDEX BGI FUND B	NA	NA	480,587	68,406,676	76,737,097	5.19%
<b>Equity Index Fund</b>			<b>480,587</b>	<b>68,406,676</b>	<b>76,737,097</b>	<b>5.19%</b>
MONOGENESIS CORP	NA	NA	1	0	0	0.00%
OCEAN WEST HOLDING CORP	NA	NA	100	15	140	0.00%
<b>Equity Other</b>			<b>101</b>	<b>15</b>	<b>140</b>	<b>0.00%</b>
MONTANA RESIDENTIAL MORTGAGES	NA	NA	92,939,453	92,939,453	93,811,197	6.35%
MONTANA PERMANENT COAL TAX TRUST LOANS	NA	NA	212,353,581	212,353,581	212,353,581	14.37%
<b>Mortgages/Loans</b>			<b>305,293,033</b>	<b>305,293,033</b>	<b>306,164,778</b>	<b>20.72%</b>
2273 BOOT HILL COURT, BOZEMAN MONTANA	NA	NA	2,073,887	2,073,887	2,082,014	0.14%
CALIFORNIA STREET, HELENA MONTANA	NA	NA	204,835	204,835	210,521	0.01%
2401 COLONIAL DRIVE, HELENA MONTANA	NA	NA	7,090,594	7,090,594	7,581,000	0.51%
1712 NINTH AVENUE, HELENA MONTANA	NA	NA	511,312	511,312	576,369	0.04%
100 NORTH PARK AVENUE, HELENA MONTANA	NA	NA	6,435,601	6,435,601	6,024,526	0.41%
<b>Equity Real Estate</b>			<b>16,316,230</b>	<b>16,316,230</b>	<b>16,474,430</b>	<b>1.11%</b>
<b>Total All Other Funds</b>			<b>1,395,401,727</b>	<b>1,455,078,161</b>	<b>1,477,780,667</b>	<b>100.00%</b>

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Assets of the Enterprise Fund of the state of Montana Board of Investments as of June 30, 2005, and 2004, and the related Statement of Revenues, Expenses, and Changes in Fund Net Assets and Statement of Cash Flows for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Enterprise Fund of the Montana Board of Investments and are not intended to present fairly the financial position, of the state of Montana as of June 30, 2005, and 2004, and the results of operations and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the state of Montana Board of Investments' Enterprise Fund as of June 30, 2005, and 2004, and the results of its operations and cash flows of its Enterprise Fund for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

November 2, 2005

**B-74**



**STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND  
STATEMENT OF NET ASSETS AS OF JUNE 30, 2005 AND 2004**

**Assets**

	<u>2005</u>	<u>2004</u>
<b>Current assets:</b>		
Cash and cash equivalents (Note 1)	\$ 17,150,825	\$ 7,534,708
Interest receivable	837,279	735,782
Notes/loans receivable (Note 1)	9,472,930	9,176,128
Interfund notes/loans and interest receivable (Note 1)	3,695,207	3,141,523
Component Unit notes/loans and interest receivable (Note 1)	1,661,436	1,195,650
Short-term investments at fair value (Notes 1 and 2)	1,806,558	23,243,262
Prepaid expenses	<u>23</u>	<u>18</u>
<b>Total current assets</b>	<u>34,624,258</u>	<u>45,027,071</u>
<b>Noncurrent assets:</b>		
Restricted investments at fair value (Notes 1 and 2)	4,073,621	4,394,269
Notes/loans receivable (Note 1)	34,081,800	36,174,241
Interfund notes/loans and interest receivable (Note 1)	14,012,262	9,181,931
Component Unit notes/loans receivable (Note 1)	6,644,152	6,262,003
Investments at fair value (Notes 1 and 2)	17,910	236,974
Capitalized cost of issue (Note 1)	1,392,790	1,506,489
Equipment	2,990	12,240
Accumulated depreciation	<u>(2,686)</u>	<u>(8,078)</u>
<b>Total noncurrent assets</b>	<u>60,222,839</u>	<u>57,760,069</u>
<b>Total assets</b>	\$ <u>94,847,097</u>	\$ <u>102,787,140</u>
<b>Liabilities</b>		
<b>Current liabilities:</b>		
Advances	\$ 415,450	\$ 98,687
Due to other funds	2,855	6,084
Accrued expenses	10,773	14,694
Accrued interest payable	904,426	612,771
Deferred cost of issue recovery	0	17,785
Arbitrage rebate tax payable	0	83,819
Compensated absences	19,312	11,343
Current bonds/notes payable (Note 4)	<u>85,753,517</u>	<u>92,227,028</u>
<b>Total current liabilities</b>	<u>87,106,333</u>	<u>93,072,211</u>
<b>Noncurrent liabilities</b>		
Bonds/notes payable (Note 4 )	2,434,753	4,615,051
Compensated absences	23,509	13,609
Arbitrage rebate tax payable	<u>114,154</u>	<u>55,716</u>
<b>Total noncurrent liabilities</b>	<u>2,572,416</u>	<u>4,684,376</u>
<b>Total liabilities</b>	\$ <u>89,678,749</u>	\$ <u>97,756,587</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	\$ 304	\$ 4,162
Restricted (Note 1)	2,504,067	2,763,134
Unrestricted	<u>2,663,977</u>	<u>2,263,257</u>
<b>Total net assets (Note 7)</b>	\$ <u>5,168,348</u>	\$ <u>5,030,553</u>
<b>Total liabilities and net assets</b>	\$ <u>94,847,097</u>	\$ <u>102,787,140</u>

The accompanying notes are an integral part of these financial statements.



**STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004**

<b>Operating revenue</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Reimbursements	\$ 4,671	\$ 7,939
Investment income	636,922	82,642
Security lending income	0	0
Financing income	<u>2,125,548</u>	<u>2,161,416</u>
<b>Total operating revenue</b>	<b><u>2,767,141</u></b>	<b><u>2,251,997</u></b>
<b>Operating expenses</b>		
Personal services	252,489	186,075
Contracted services	31,059	33,431
Supplies and materials	3,406	6,602
Communications	6,359	6,344
Travel	4,299	3,988
Rent	40,243	39,231
Repair and maintenance	288	655
Indirect and other costs	29,872	26,591
Depreciation expense	913	1,958
Arbitrage rebate tax expense	66,646	40,127
Security lending expense	0	0
Debt service		
Interest expense	1,824,510	1,519,894
Trustee fee expense	61,628	49,849
Bond issuance cost amortization expense	114,903	131,473
Other debt service expense	189,786	150,346
<b>Total operating expenses</b>	<b><u>2,626,401</u></b>	<b><u>2,196,564</u></b>
<b>Operating income</b>	<b><u>140,740</u></b>	<b><u>55,433</u></b>
<b>Nonoperating (expense):</b>		
Loss on disposal of fixed assets	<u>(2,945)</u>	<u>0</u>
<b>Change in net assets</b>	<b>137,795</b>	<b>55,433</b>
<b>Beginning net assets</b>	<b><u>5,030,553</u></b>	<b><u>4,975,120</u></b>
<b>Ending net assets (Note 8)</b>	<b>\$ <u>5,168,348</u></b>	<b>\$ <u>5,030,553</u></b>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND  
STATEMENT OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b>Cash flows from operating activities:</b>		
Receipts for sales and services	\$ 4,671	\$ 7,939
Payments to suppliers for goods and services	(118,993)	(117,308)
Payments to employees	(238,308)	(188,127)
<b>Net cash (used for) operating activities</b>	<u>(352,630)</u>	<u>(297,496)</u>
<b>Cash flows from non-capital financing activities:</b>		
Payment of principal and interest on bonds and notes	(10,616,278)	(4,987,227)
Proceeds from issuance of bonds and notes	176,996	18,600,621
Payment of bond issue costs	0	(401,007)
<b>Net cash (used for) provided by non-capital financing activities</b>	<u>(10,439,282)</u>	<u>13,212,387</u>
<b>Cash flows from capital and related financing activities:</b>		
Acquisition of fixed assets	0	0
<b>Net cash (used for) capital and related financing activities</b>	<u>0</u>	<u>0</u>
<b>Cash flows from investing activities:</b>		
Collections for principal and interest on loans	20,285,591	28,978,347
Cash payments for loans	(22,370,759)	(29,923,593)
Purchase of investments	(1,333,514)	(28,131,728)
Proceeds from security lending	0	0
Security lending costs	0	0
Proceeds from sales or maturities of investments	23,226,880	12,577,928
Interest on investments	691,858	373,014
Payments for arbitrage rebate tax	(92,027)	(71,229)
<b>Net cash provided by (used for) investing activities</b>	<u>20,408,029</u>	<u>(16,197,261)</u>
Net increase (decrease) in cash and cash equivalents	9,616,117	(3,282,369)
Cash and cash equivalents, July 1	<u>7,534,708</u>	<u>10,817,077</u>
Cash and cash equivalents, June 30	<u>17,150,825</u>	<u>7,534,708</u>
<b>Reconciliation of net income to net cash (used for) operating activities:</b>		
Net operating income	140,740	55,433
Adjustments to reconcile net income to net cash (used for) operating activities		
Depreciation	913	1,958
Interest on investments	(636,922)	(82,642)
Financing income	(2,125,548)	(2,161,416)
Interest expense	2,190,827	1,851,563
Security lending income	0	0
Security lending expense	0	0
Arbitrage rebate tax expense	66,646	40,127
Change in assets and liabilities:		
Increase/decrease in other assets	(5)	18
Increase/decrease in other payables	(3,921)	3,676
Increase/decrease in due to other funds	(3,229)	(196)
Increase/decrease in compensated absences payable	<u>17,869</u>	<u>(6,017)</u>
<b>Total adjustments</b>	<u>(493,370)</u>	<u>(352,929)</u>
<b>Net cash (used for) operating activities</b>	\$ <u>(352,630)</u>	\$ <u>(297,496)</u>
<b>Schedule of noncash transactions:</b>		
Increase/decrease in fair value of investments	\$ <u>(8,574)</u>	\$ <u>(234,794)</u>
<b>Total noncash transactions</b>	\$ <u>(8,574)</u>	\$ <u>(234,794)</u>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND**

**NOTES TO FINANCIAL STATEMENTS  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND JUNE 30, 2004**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**a. Basis of Accounting**

The Board uses the accrual basis of accounting for the Enterprise Fund. Under the accrual basis of accounting, expenses are recorded when incurred and revenues are recorded when earned. The financial statements are prepared from the Statewide Accounting, Budgeting, and Human Resource System (SABHRS) and information contained in the bond trustee statements. The statements include the financial activity administered by the Board in the Enterprise Fund.

**b. Presentation of Programs**

The Board uses the Enterprise Fund to account for its programs created under the Economic Development Bond Act and the Municipal Finance Consolidation Act.

Economic Development Bond Act programs include:

- The Stand Alone Economic Development Bond Program provides access to limited economic development projects through the issuance of conduit debt.
- The Conservation Reserve Enhancement Program (CRP), created in 1990 by issuing bonds, allows farmers to receive a lump sum payment by assigning their federal CRP contract to the Board. The farmers under contract must comply with seeding and other requirements. The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.
- The Family Friendly Business Loan Program provides zero interest loans to qualified business owners who hire participants of the Families Achieving Independence in Montana (FAIM) employment and training component. The Department of Health and Human Services pays the interest on the loans.

Municipal Finance Consolidation Act programs include:

- The INTERCAP loan program provides funds to eligible Montana governments to finance capital expenditures for up to ten years.
- The Irrigation District Pooled Loan Program provided funds for the Board to purchase the refunding bonds from participating irrigation districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans.
- The School District Pooled Refunding Program provided funds for the Board to purchase the general obligation refunding bonds of participating Montana School Districts. These bonds matured in January 2005.

**c. Fixed Asset Depreciation**

The equipment fixed assets recorded in the Enterprise Fund are depreciated on a straight-line basis, with salvage value, in accordance with state policy.

**d. Receivables**

The Enterprise Fund notes/loans receivables of \$69,225,770 as of June 30, 2005, and \$64,962,608 as of June 30, 2004, represent loans made to Montana businesses, state and local governments. The Enterprise Fund notes/loans are classified in three categories as follows:

- 1) Notes/loans receivable from local governments and Montana businesses
- 2) Interfund notes/loans receivable from state agency governments
- 3) Component Unit notes/loans receivable from certain state agencies and university units for which the State is financially accountable.

As of June 30, 2005 and 2004, there were no uncollectible account balances. However, in November 2003, the Enterprise Fund wrote off a loan principal balance of \$10,791 for the Rosebud Food and Fuel loan. The Family Friendly Business Loan Program funded \$27,000 for this loan in June 1999.

The InterFund notes/loans receivable as of June 30, 2005 and 2004 includes \$342,017 and \$168,868, respectively, in interest accruals from state agencies and university units.

**e. Capitalized Cost of Issue**

The Enterprise Fund capitalized cost of issue asset of \$1,392,790 and \$1,506,489 as of June 30, 2005 and June 30, 2004, respectively, represents paid bond issuance costs which have been capitalized and are being amortized, using the straight-line method, over the life of the bonds.

**f. Cash and Cash Equivalents**

For purposes of the Statement of Cash Flows, the Enterprise Fund considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents, as identified in the Statement of Net Assets, are as follows:

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Cash in treasury	\$ 19,787	\$ 24,756
Cash with fiscal agent	0	2,490,280
Short Term Investment Pool (STIP)	196,544	186,263
First American Treasury Obligation Fund	<u>16,934,494</u>	<u>4,833,409</u>
Total Cash and Cash Equivalents	\$ <u>17,150,825</u>	\$ <u>7,534,708</u>

The Enterprise Fund invests its operational cash in the Board's Short Term Investment Pool (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

**g. Restricted Net Assets**

The Statement of Net Assets for the Enterprise Fund reports restricted assets. Net assets are reported as restricted when constraints placed on net asset use are either:

- a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or
- b. Imposed by law through constitutional provisions or enabling legislation.

The net assets of all Enterprise Fund programs with the exception of MEDB (Montana Economic Development Bonds) Guarantee Fund Account, MEDB Guarantee CRP Note Reserve, MEDB Contingency Account, MEDB Family Friendly Account and CRP are restricted under bond indentures governing the use of these funds.

**h. Investments**

Investments are presented in the Statement of Net Assets at fair value. Investment fair values for publicly traded securities are determined primarily by reference to market prices supplied to the Board's trustee. Amortized cost, or carrying value, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line method to the maturity date of the securities.

**2. INVESTMENT RISK DISCLOSURES**

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The financial statement disclosures for the year ended June 30, 2004 have been restated to compare with the financial statement disclosures for the year ended June 30, 2005. The investment risk disclosures are described in the following paragraphs.

The Enterprise Fund deposits and investments are restricted by the bond trust indentures to the following: government and agency obligations, certificates of deposits, repurchase agreements, and investment agreements. Deposits and investments must be made with Montana banks or in the Short Term Investment Pool (STIP) administered by the Board.

### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Enterprise Fund's U.S. government direct-backed securities, consisting of U.S. Treasury notes and bills, are guaranteed directly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the following table are provided by S&P's rating services.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2005 and 2004, Enterprise Fund securities were recorded in book entry form in the name of U.S. Bank National Association as Trustee for the Montana Board of Investments by specific account.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Enterprise Fund investments represent investments directly issued or explicitly guaranteed by the U.S. government and investments in mutual funds. These investments are excluded from the concentration of credit risk requirement.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Enterprise Funds' bond indentures do not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the duration method to disclose interest rate risk.

State of Montana Enterprise Fund investments are categorized below to disclose credit and interest rate risk as of June 30, 2005 and June 30, 2004. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using duration as calculated by Board staff. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

#### **Credit Quality Rating and Effective Duration as of June 30, 2005**

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
First American Treasury Obligation Fund	\$ 16,934,494	AAA	NA
Short Term Investment Pool (STIP)	196,544	NR	NA
U.S. Government Direct-Backed	5,898,089	AAA	2.05
Total Investments	\$ 23,029,127	AAA	2.05
Securities Lending Collateral Investment Pool	\$ 0	NR	NA

#### **Credit Quality Rating and Effective Duration as of June 30, 2004**

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
First American Treasury Obligation Fund	\$ 4,833,409	AAA	NA
Short Term Investment Pool (STIP)	186,263	NR	NA
U.S. Government Direct-Backed	27,874,505	AAA	0.70
Total Investments	\$ 32,894,177	AAA	0.70
Securities Lending Collateral Investment Pool	\$ 0	NR	NA

There were no derivative transactions during the above fiscal years for investments held by the trustee.

### 3. SECURITY LENDING

The Enterprise Fund is a participant in the Board's Short Term Investment Pool (STIP). STIP had no security lending transactions in fiscal years 2005 and 2004.

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's STIP securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 100 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

### 4. BONDS PAYABLE

#### Long-Term Bonds Payable

#### Economic Development Bonds (EDB) and Municipal Finance Consolidation Act Bonds (MFCAB)

These bonds are issued under the Economic Development Bond Act, and the Municipal Finance Consolidation Act, for the purpose of assisting Montana's small businesses and local governments in obtaining low cost financing. Outstanding obligations are listed as follows (in thousands):

#### Bonds Payable as of June 30, 2005

<u>Program</u>	<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range %</u>	<u>Principal Payments FY 2006</u>	<u>@ Maturity</u>	<u>Balance June 30, 2005</u>
Municipal Finance Consolidation Act Bonds (Irrigation Program) (1)	1988	4,976	6.60-7.75	450	70 (2014)	880
Conservation Reserve Enhancement Program (CRP Bonds) (2)		3,028	6.00-8.00	1,024	33 (2008)	3,028
Total Bonds Payable		<u>\$ 8,004</u>		<u>\$ 1,474</u>		<u>\$ 3,908</u>
Less Current Portion (FY2005 Principal Payments)						(1,473)
Total Long-Term Bonds Payable						<u>\$ 2,435</u>

#### Bonds Payable as of June 30, 2004

<u>Program</u>	<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range %</u>	<u>Principal Payments FY 2005</u>	<u>@ Maturity</u>	<u>Balance June 30, 2004</u>
Municipal Finance Consolidation Act Bonds (Irrigation Program) (1)	1988	4,976	6.60-7.75	325	130 (2014)	1,205
Municipal Finance Consolidation Act Bonds (School District Pooled Refunding Program) (3)	1991	6,234	4.75-6.50	294	294 (2005)	294
Conservation Reserve Enhancement Program (CRP Bonds) (2)		4,789	6.00-8.00	1,053	377 (2009)	4,789
Total Bonds Payable		<u>\$ 15,999</u>		<u>\$ 1,672</u>		<u>\$ 6,288</u>
Less Current Portion (FY2004 Principal Payments)						(1,672)
Total Long-Term Bonds Payable						<u>\$ 4,616</u>

(1) The Board issued these bonds to provide funds to purchase the Refunding Bonds of participating Irrigation Districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans. The Irrigation Bonds and the interest thereon are payable solely from the collection of a special tax or assessment which is a lien against real property in the Irrigation District. While the Irrigation Bonds are not obligations of the State of Montana, the bonds are limited obligations of the Board due to an irrevocable pledge to lend money for deposit by the Trustee of the Irrigation District Pooled Loan Program Reserve Account E in an amount equal to any deficiencies therein on any payment date. The Indenture does not permit the issuance of additional bonds. On May 31, 2005, the East Bench Irrigation District voted to redeem their bonds on August 1, 2005.

(2) The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.

(3) The Board issued these bonds to provide funds to purchase the general obligation refunding bonds of participating Montana School Districts. The School District Refunding Bonds and the interest thereon are payable from real property taxes levied within the school district. The 1991 Bonds are limited obligations of the Board, and are not a debt or liability of the State of Montana, and neither the faith and credit nor the taxing power of the state is pledged to the payment of principal of or interest on the bonds. These bonds matured in January 2005.

Future debt service as of June 30, 2005 is listed below (in thousands):

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011-14</u>	<u>Total</u>
Principal	\$ 1,474	\$ 1,005	\$ 1,051	\$ 78	\$ 50	\$ 250	\$ 3,908
Interest	\$ 251	\$ 164	\$ 97	\$ 27	\$ 21	\$ 40	\$ 600
Total	<u>\$ 1,725</u>	<u>\$ 1,169</u>	<u>\$ 1,148</u>	<u>\$ 105</u>	<u>\$ 71</u>	<u>\$ 290</u>	<u>\$ 4,508</u>

Future debt service as of June 30, 2004 is listed below (in thousands):

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010-14</u>	<u>Total</u>
Principal	\$ 1,468	\$ 1,205	\$ 1,161	\$ 1,228	\$ 462	\$ 560	\$ 6,084
Interest	\$ 641	\$ 337	\$ 249	\$ 164	\$ 74	\$ 114	\$ 1,579
Total	<u>\$ 2,109</u>	<u>\$ 1,542</u>	<u>\$ 1,410</u>	<u>\$ 1,392</u>	<u>\$ 536</u>	<u>\$ 674</u>	<u>\$ 7,663</u>

#### Current Bonds Payable

The Enterprise Fund is authorized to issue INTERCAP bonds under the Municipal Finance Consolidation Act. These bonds may not aggregate more than \$120 million as amended by the 2003 Legislature. The INTERCAP bonds provide funds for the Board to make loans to eligible government units. The bonds are not a debt or liability of the State of Montana. The bonds are limited obligations of the Board payable solely from: a) repayments of principal and interest on loans made by the Board to participating eligible Montana governments; b) investment income under the indenture; and c) an irrevocable pledge by the Board. The Board has no taxing power. These bonds may be redeemed, at the bondholder's option, any March 1, prior to maturity. The Board did not enter into an arms-length financing agreement to convert the bonds "put", but not resold into some other form of long-term obligation. Accordingly, these bonds, considered demand bonds, are recorded as current liabilities of the Enterprise Fund.

The INTERCAP obligations at June 30, 2005 and June 30, 2004, are listed below (in thousands):

<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range</u>	<u>Maturity</u>	<u>Balance June 30, 2005</u>	<u>Balance June 30, 2004</u>
1992	6,500	Variable	2005	\$ 0	\$ 6,055
1994	7,500	Variable	2009	6,810	6,895
1995	7,500	Variable	2010	6,995	7,080
1997	10,000	Variable	2017	9,690	9,740
1998	12,500	Variable	2018	12,285	12,285
2000	15,000	Variable	2025	15,000	15,000
2003	15,000	Variable	2028	15,000	15,000
2004	<u>\$18,500</u>	Variable	2029	<u>18,500</u>	<u>18,500</u>
Total INTERCAP Debt	<u>\$92,500</u>			<u>84,280</u>	<u>90,555</u>
Current Portion of Long-Term Bonds Payable				<u>1,473</u>	<u>1,672</u>
Current Bonds Payable				\$ <u>85,753</u>	<u>92,227</u>

## 5. OTHER DEBT

### Conduit Debt

In this program, the Board is authorized to issue stand-alone industrial revenue bonds, under the Economic Development Act, as conduit (no commitment) debt. Assets and revenues of the borrower are pledged to repay the bonds. Because the Board has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued by the Board as conduit (no-commitment) debt are listed below (in thousands):

<u>Project</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount Issued</u>	<u>Balance June 30, 2005</u>	<u>Balance June 30, 2004</u>
Colstrip	October 1989	12/30/15	60,800	53,100	55,300
Yellowstone Energy (BGI)	July 1993	12/31/19	118,345	116,345	116,945
Stillwater Mining	July 2000	07/01/20	30,000	30,000	30,000
Gainey Foundation	October 2002	09/01/14	<u>6,000</u>	<u>5,140</u>	<u>5,570</u>
Total conduit debt			<u>\$ 215,145</u>	<u>\$ 204,585</u>	<u>\$ 207,815</u>

### QZAB Debt

In this program, the Board is authorized to issue Qualified Zone Academy Bonds (QZAB), under the Municipal Finance Consolidation Act, as conduit (no commitment) debt. The revenues, and in some cases the taxing power, of the borrower are pledged to repay the bonds. Because the Board has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued by the Board as QZAB conduit (no-commitment) debt are listed below (in thousands):

<u>Project</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount Issued</u>	<u>Balance June 30, 2005</u>	<u>Balance June 30, 2004</u>
Huntley Project K-12 Schools	December 2000	07/01/13	\$ 750	\$ 750	\$ 750
Bozeman Public Schools	November 2003	11/25/12	1,586	1,586	1,586
Philipsburg Schools	December 2003	12/10/17	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>
Total QZAB conduit debt			<u>\$ 4,336</u>	<u>\$ 4,336</u>	<u>\$ 4,336</u>

In August 2005, the Board issued two QZABs for the Cut Bank school district totaling \$825,000 and \$625,000, respectively, for the elementary and high schools.

## 6. INTERCAP PROGRAM LOAN COMMITMENTS

The Board makes firm commitments to fund loans from the INTERCAP loan program. As of June 30, 2005 and 2004, respectively, the Board committed to make loans to eligible Montana governments totaling \$39,207,721 and \$37,068,745.

## 7. NET ASSETS

Net Assets represents the accumulated net profits of the Enterprise Fund programs. The Net Assets for fiscal years ended June 30, 2005 and June 30, 2004 include (\$50,546) and (\$41,971), respectively, in unrealized appreciation/depreciation in reporting the fair value of the Enterprise Fund investments.



# MONTANA BOARD OF INVESTMENTS

Street Address:  
2401 Colonial Drive, 3<sup>rd</sup> Floor  
Helena, MT 59601

Mailing Address:  
P.O. Box 200126  
Helena, MT 59620-0126

Department of Commerce



Phone: 406/444-0001  
Facsimile: 406/449-6579  
Rateline: 406/444-3557  
Website: [www.investmentmt.com](http://www.investmentmt.com)

November 22, 2005

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NOV 23 2005

LEGISLATIVE AUDIT DIV.

Scott A. Seacat, Legislative Auditor  
Legislative Audit Division  
Room 135, State Capitol  
Helena MT 59620-1705

Dear Scott:

We appreciate the services your staff provide to the Board of Investments in reviewing our procedures, internal controls, accounting practices, and the accuracy of our financial statements. At the end of Fiscal 2005, the Board invested \$10.5 billion of public funds and during the year handled investments for 463 state and local government accounts. Our operation utilizes five different accounting systems to accurately track investments in various asset classes.

We take the responsibility of managing the constitutionally-established Unified Investment Program very seriously and depend upon your objective annual review of our operations to detect any problems that we may not observe.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Carroll South".

Mr. Carroll South, Executive Director  
Montana Board of Investments